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STATE OF INDIANA

BEFORE THE INDIANA UTILITY REGULATORY COMMISSION

FILED

DEC 10 2008

INDIANA UTILITY
REGULATORY COMMISSION

PETITION OF INDIANA MICHIGAN)
POWER COMPANY, AN INDIANA)
CORPORATION, FOR AUTHORITY TO)
INCREASE ITS RATES AND CHARGES)
FOR ELECTRIC UTILITY SERVICE; FOR)
APPROVAL OF NEW SCHEDULES OF)
RATES, RULES AND REGULATIONS; AND)
FOR AUTHORITY TO ESTABLISH AND)
IMPLEMENT RATE ADJUSTMENT MECHANISMS)
TO TRACK CERTAIN MATTERS RELATING TO)
RELIABILITY ENHANCEMENT, DEMAND-SIDE)
MANAGEMENT/ ENERGY EFFICIENCY)
PROGRAMS, OFF-SYSTEM SALES MARGINS,)
PJM, ENVIRONMENTAL COMPLIANCE, AND)
CAPACITY EQUALIZATION SETTLEMENT.)

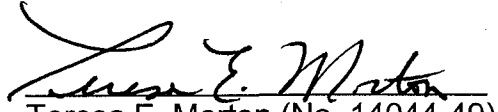
CAUSE NO. 43306

SUBMISSION OF VERIFIED SUPPLEMENTAL TESTIMONY
IN SUPPORT OF SETTLEMENT

Petitioner Indiana Michigan Power Company ("I&M"), by counsel, in accordance with the procedural schedule established on December 1, 2008, hereby submits the Verified Supplemental Testimony in Support of Settlement of its witnesses Marc E. Lewis and Kent D. Curry. Because the Stipulation and Settlement Agreement ("Settlement Agreement") was previously filed with the Commission on December 4, 2008, an additional copy of the Settlement Agreement is not included with the supplemental testimony. The Settlement Agreement will be offered into evidence as Joint Exhibit 1 at the hearing on the settlement.

Additionally, at the hearing on the Settlement Agreement and subject to Commission approval, the Parties propose to offer all witnesses testifying in support of the Settlement Agreement for questioning by the Commission as a panel.

Respectfully submitted,


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CERTIFICATE OF SERVICE

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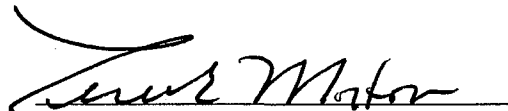
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Teresa E. Morton

INDIANA MICHIGAN POWER COMPANY

CAUSE NO. 43306

VERIFIED SUPPLEMENTAL TESTIMONY

IN SUPPORT OF SETTLEMENT

OF

MARC E. LEWIS

**VERIFIED SUPPLEMENTAL TESTIMONY IN SUPPORT OF SETTLEMENT
OF MARC E. LEWIS
ON BEHALF OF
INDIANA MICHIGAN POWER COMPANY**

1 **Q. Please state your name and business address.**

2 A. My name is Marc E. Lewis. My business address is One Summit Square, P.O.
3 Box 60, Fort Wayne, Indiana, 46801.

4 **Q. By whom are you employed and in what capacity?**

5 A. I am employed by Indiana Michigan Power Company ("I&M" or "Company") as
6 Vice President External Relations.

7 **Q. Please briefly describe your educational and business experience.**

8 A. I received a Bachelor of Science degree in Economics from the University of
9 Kentucky in 1977 and a Juris Doctorate degree from the Ohio State University in
10 1981. I represented the Staff of the Public Service Commission of West Virginia
11 from 1981 to 1986, focusing on electricity and telecommunications regulation.
12 From 1986 to 2004, I represented I&M and other affiliated companies in
13 regulatory proceedings in Indiana, Michigan, Texas, Oklahoma, Louisiana and
14 Arkansas, focusing primarily on I&M regulatory, corporate, bankruptcy, litigation,
15 and legislative matters as a Staff Attorney, Senior Attorney and then Assistant
16 General Counsel. In 2005, I accepted the position of Vice President – External
17 Relations and have responsibilities for governmental and regulatory relations. I
18 am actively involved in legislative and regulatory matters. I am a member of the
19 Indiana Wind Working Group, which is a task force of diverse interests
20 assembled by the Indiana Office of Energy Development to explore and support
21 the development of Indiana's wind resources. I have also been involved with the

deliberations in the past three sessions of the Indiana General Assembly considering the adoption of a Renewable Portfolio Standard (RPS) that extensively focused on the deployment of wind resources. I am also the lead for I&M on I&M's efforts to explore the possibility of developing a wind farm in east central Indiana. Throughout my career I have been involved in industry associations and participated in numerous industry conferences. For example, I was Chair of the Utility Law Section of the Indiana State Bar Association in 1994/95. I served this organization in numerous other capacities before and after my term as Chair. I currently serve this organization as Chair. I have spoken on regulatory and industry issues at various conferences. I regularly attend the National Association of Regulatory Commissioners and other industry conferences. I represent I&M in the Indiana Energy Association, a trade association (made up of Indiana electric and gas utilities) that works on energy policy to improve the economy and quality of life in Indiana. As a member of I&M's executive management team, I have responsibility (together with the other team members) for the overall direction and strategy of the Company. In sum, as a result of my background, education and experience, I have extensive experience with public utility regulation and public policy, particularly as it relates to the electric industry and I&M.

Q. What is the purpose of your testimony in this proceeding?

A. I acted as the lead negotiator for I&M in this case and as such had substantial involvement in the negotiation and preparation of the Stipulation and Settlement Agreement ("Settlement Agreement") filed in this proceeding by all Parties. Together with the testimony of Joan M. Soller and Kent D. Curry, my testimony

1 provides an overview of the Settlement Agreement that the Parties request the
2 Commission to approve and also explains why the Parties urge the Commission
3 to find that the Settlement Agreement is in the public interest and should be
4 approved.

5 **Q. On whose behalf are you testifying?**

6 A. I am testifying on behalf of I&M. While the Parties have reviewed and had an
7 opportunity to comment on the testimony I am providing prior to its filing, I note
8 that the other Parties may not agree with all opinions and explanations contained
9 in the testimony. My testimony does not change the substance of the Settlement
10 Agreement and I am authorized by all Parties to inform the Commission that all
11 Parties believe that: (a) the Settlement Agreement as a whole produces fair and
12 reasonable rates; (b) approval of the Settlement Agreement is in the public
13 interest; and all Parties (c) strongly encourage the Commission, after considering
14 the evidence in support of the Settlement Agreement, to find the Settlement
15 Agreement to be reasonable and in the public interest and promptly enter an
16 order approving the Settlement Agreement in its entirety.

17 **Q. Are you sponsoring any exhibits?**

18 A. Yes. Together with witnesses Soller and Curry, I sponsor Joint Exhibit 1, which
19 is a copy of the Settlement Agreement.

20 **Q. Is the Settlement Agreement a product of serious bargaining among**
21 **capable and knowledgeable parties?**

22 A. Yes. The Parties represent a diverse group of constituents with differing views
23 on the complicated issues raised in the proceeding. The Settlement Agreement

1 is the result of substantial negotiations and investigation of the concerns raised in
2 this proceeding. Experts were involved with legal counsel in the development of
3 both the conceptual framework and the details of the proposed settlement. Many
4 hours were devoted by all Parties to settlement negotiations both before and
5 after the agreement in principle was reached.

6 As reflected by the testimony submitted in this proceeding, there was robust,
7 even passionate, disagreement among the various Parties in five general
8 categories: off system sales margins sharing; rate adjustment mechanisms;
9 disputed revenue requirement adjustments; cost-of-service; and rate design. In
10 particular, the evidence submitted by the Parties reflects a \$140 million difference
11 between the ratemaking relief sought by I&M and certain calculations proposed
12 by the other Parties. To bridge this wide gap, the Parties dedicated significant
13 time and effort to thoroughly understand the evidence submitted in this Cause
14 and the challenges facing the Company in particular and the industry in general,
15 including the Company's needs in light of current financial market conditions, and
16 other issues.

17 The Parties considered various options and evaluated all the issues to reach a
18 settlement that is comprehensive, balanced, and in the public interest. The
19 adverse and conflicting positions regarding the disputed issues could not have
20 been resolved without substantial effort and serious give and take within the
21 negotiation process. I&M appreciates the willingness of the other Parties to
22 engage in the rigorous process that resulted in the Settlement Agreement. The
23 process and the results reflected in the Settlement Agreement produce just and

1 reasonable rates that balance the interests of the various stakeholders and the
2 overall public interest.

3 Each signatory was authorized to execute the Settlement Agreement on behalf of
4 his or her respective client(s). Given the issues raised by I&M and the other
5 Parties to this proceeding, it is certain that continuing litigation would be costly,
6 time consuming and risky for all. The Settlement Agreement resolves this
7 litigation and thereby avoids the cost in terms of actual dollars and inefficiency,
8 as well as regulatory uncertainty for all Parties, of ongoing litigation.

9 **Q. Are you familiar with the Commission's policy and standard of review**
10 **regarding settlement agreements?**

11 A. Yes. The Commission's rules, 170 IAC 1-1.1-17, provide that it is the policy of
12 the Commission to review and accept appropriate settlements. A settlement
13 must be supported by probative evidence so that the Commission may make
14 appropriate findings of fact in its decision and determine whether the evidence
15 supports the Commission's conclusion regarding the settlement. The
16 Commission may reject, in whole or in part, any proposed settlement if the
17 Commission determines the settlement is not in the public interest.

18 The Commission's policy is consistent with the general public policy favoring
19 settlement. As the Commission has previously found, settlements are favored as
20 a matter of policy because they help advance matters with far greater speed and
21 certainty, and far less drain on public and private resources, than litigation or

1 other adversarial proceedings.¹ In a litigated context, the Commission is the sole
 2 entity involved in resolving disputes. In the settlement context, the parties are
 3 also involved with and satisfied by the resolution. This benefit, as well as the
 4 conservation of valuable Commission time and effort, is in the public interest.

5 We recognize that the Commission will closely examine the Settlement
 6 Agreement and evidentiary record and must determine on its own whether it is
 7 reasonable and in the public interest. We are aware that in other cases the
 8 Commission has modified settlement agreements when the Commission has
 9 found that modification is necessary in order to find the settlement agreement is
 10 in the public interest. In reaching agreement in this case, the Parties have
 11 attempted to take previous Commission decisions into account. For example, in
 12 other cases the Commission has clarified that it interpreted settlement
 13 agreements regarding amortization of certain expenses to require an adjustment
 14 in rates once the amortization periods expire. This issue is expressly addressed
 15 in the Settlement Agreement. This approach was taken not to gloss over the
 16 importance of Commission review but in recognition of the request for expedited
 17 consideration and approval of the Settlement Agreement. The fact that all
 18 Parties have joined in this Settlement Agreement is, I believe, strong additional
 19 evidence that the Settlement Agreement is in the public interest.

¹ *Re Investigation*, Cause No. 42045-S1 (IURC 6/1/2005) at 5 ("As in other litigation contexts, negotiated settlements of administrative proceedings can help advance legal and policy objections with far greater speed and certainty, and far less drain on public and private resources, than litigation or other adversarial proceedings) citing *Mendenhall v. Skinner & Broadbent Co.*, 728 N.E.2d 140, 145 (Ind. 2000) ("The policy of the law generally is to discourage litigation and encourage negotiation and settlement of disputes.") and *In re Assignment of Courtrooms, Judge's Offices and Other Facilities of St. Joseph Superior Court*, 715 N.E.2d 372, 376 (Ind. 1999) ("Without question, state judicial policy strongly favors settlement of disputes over litigation.").

I would add that the ability to obtain a Commission decision in a more timely and cost effective manner, coupled with certainty about the terms and conditions which have been negotiated, is of the utmost importance in the settlement context. Without such certainty, settlements may not be reached. Therefore, the Settlement Agreement provides that if following its examination, the Commission finds the Settlement Agreement to be in the public interest, the Settlement Agreement should be approved in its entirety and without change or condition(s) unacceptable to any Party.

Q. Please summarize the overall effect the Settlement Agreement will have on I&M's rates.

A. The Settlement Agreement provides that I&M shall be authorized to increase its basic rates and charges for retail electric service and to implement certain rate adjustment mechanisms (collectively "rates"). The rates shall be designed to produce an increase in annual revenue from retail electric service in the amount of \$44,167,000. This increase includes the revenues associated with the initial factors for the rate adjustment mechanisms. The Settlement Agreement provides that the rates shall be designed to produce total revenues from I&M's rates in the amount of \$953,928,000. This total is comprised of \$931,361,000 from basic rates; the balance is from the initial tracker factors. Based on the additional revenues of \$44,167,000, the overall revenue increase (including the first year of the rate adjustment mechanisms) is approximately 4.85%.

As explained in the rebuttal testimony of I&M witness Murray (p. 8), I&M's current retail electric rates are among the lowest in Indiana and the nation. In fact, as

1 shown by Exhibit HJM-R2, I&M's current Commission-approved rates produce
 2 the lowest monthly bills for typical residential customers among the five major
 3 investor-owned electric utilities in the State and the lowest or among the lowest
 4 monthly bills for the commercial and industrial classes. As also explained in the
 5 rebuttal testimony of witness Murray (pp. 8-9), an analysis in the July 3, 2008
 6 Wall Street Journal identified I&M as one of three utilities that charge among the
 7 lowest rates in the nation. I&M's basic retail rates have not been increased for
 8 15 years. In I&M's view, our low rates, combined with our customer satisfaction
 9 ratings, speak volumes about the Company's commitment to serving the public
 10 interest, particularly when one recognizes the effect of inflation, the \$1.8 billion of
 11 capital investment made by I&M over the past 15 years to expand and improve
 12 its distribution, transmission and generation facilities used to serve our Indiana
 13 customers, and the fact that I&M has not earned its Commission-authorized
 14 return and has faced significant challenges over the past 15 years. See Murray
 15 rebuttal, at 9-10, 31-33, 36-37; Exhibit HJM-R4.

16 If the Settlement Agreement is approved, I&M's rates will remain among the
 17 lowest in the State and well below the national average of 9.5 cents identified in
 18 witness Murray's rebuttal testimony (p. 9). The rate increase and timely cost
 19 recovery provided by the Settlement Agreement will support some of I&M's key
 20 initiatives, such as energy efficiency, economic development, and certain
 21 operation and maintenance projects, and help to maintain the financial health of
 22 the Company so that I&M may continue to provide low cost, reliable electric
 23 service to our customers.

1 **Q. Does the Settlement Agreement identify the negotiated components of the**
2 **overall revenue increase?**

3 A. Yes. Exhibit A attached to the Settlement Agreement details the overall revenue
4 increase. This negotiated resolution is within the range of the evidence
5 presented by the Parties in this proceeding. The Settlement Agreement also
6 provides significant details related to the Parties' resolution of the material
7 disputed issues in the case, including the agreed upon authorized return, rate
8 base, capital structure, off-system sales margins sharing, adjustments to test
9 year operating results, rate design, and trackers. To facilitate the implementation
10 of the Settlement Agreement, the Parties agreed it is appropriate for I&M to be
11 granted the requisite accounting authority to implement the ratemaking and
12 tracking mechanisms agreed to in the Settlement Agreement. Additional
13 information explaining how the disputed revenue and expense adjustments were
14 resolved and how they compare to I&M's case-in-chief and rebuttal testimony is
15 presented by I&M witness Curry. Witness Curry also presents information
16 regarding the rate adjustment mechanisms provided for in the Settlement
17 Agreement.

18 **Q. Please discuss the authorized return provisions of the Settlement**
19 **Agreement.**

20 A. The Settlement Agreement provides I&M should be authorized to earn a return
21 on equity equal to 10.5%. This return is based on the capital structure proposed
22 by I&M in its case-in-chief modified to reflect Industrials witness Gorman's
23 adjustment to preferred stock. This equates to a return on I&M's original cost
24 rate base of 7.62% and a return on fair value rate base testified to by I&M equal

1 to 4.64%. The Settlement Agreement provides that I&M's authorized net
2 operating income ("NOI") should be \$152,467,000.

3 As shown on I&M Exhibit F and in the direct testimony of I&M witness Avera (p.
4 5), I&M requested an 11.5% return on equity ("ROE"). OUCC witness Bolinger
5 (p. 5) proposed 9.5% and the Industrials witness Gorman (p. 38) recommended a
6 return on equity of 10.2%. On rebuttal, I&M presented additional evidence
7 regarding ROE and recent developments in the financial markets, which could
8 not have been reflected in the OUCC's and Industrials' analyses. For example,
9 witness Hawkins explained that I&M's cost of long term corporate debt has
10 increased with no expectation that interest rates for long term corporate debt will
11 return to the cost profile reflected in I&M's case-in-chief in the foreseeable future.
12 Hawkins Rebuttal at 6. Through his rebuttal testimony, Dr. Avera also responded
13 to the OUCC's and Industrials' recommendations. He explained that the
14 evidence regarding current market conditions and I&M's performance provided
15 further support for his recommended ROE.

16 The agreed upon ROE of 10.5% set forth in the Settlement Agreement is within
17 the range of the evidence submitted by the Parties in this Cause and consistent
18 with returns recently authorized by the Commission.² The opportunity to earn a
19 fair return is key to I&M's ability to maintain and support its credit and to attract
20 the capital necessary to discharge the Company's public duties. While the
21 agreed upon 10.5% ROE is less than what I&M sought and supported in its

² For example, in *Re PSI Energy, Inc.*, Cause No. 42359 (IURC 5/18/2004) ("Duke Indiana Order") (p. 53), the Commission authorized a return on equity of 10.5%. In *Re Southern Indiana Gas & Elec. Co.*, Cause No. 43111 (IURC 8/15/2007) ("Vectren South Order"), the Commission approved a settlement agreement which provided for a return on equity of 10.4%.

testimony, in the spirit of compromise, I&M has agreed to the 10.5% ROE as part of a complete settlement package and to achieve rate relief sooner than would otherwise be expected if these matters were litigated.

Q. What is the basis for the rate base reflected in the Settlement Agreement?

A. The limited disputes regarding certain components of I&M's rate base raised in the evidence submitted by the other Parties are resolved by the Settlement Agreement. More specifically, the rate base identified in the Settlement Agreement reflects the use of I&M's as-filed proposal modified to remove the pre-paid pension asset as provided in Section 12 of the Settlement Agreement and to include the non-leased nuclear fuel inventory as provided in Section 14 of the Settlement Agreement. The 4.64% return on fair value provided under the Settlement Agreement is within the range of evidence³ and reasonable when compared to other Commission decisions.⁴ The Duke Indiana Order (p. 53) reflects that the Commission took Duke Indiana's performance, including the results of customer satisfaction studies and Duke Indiana's cost-competitiveness, into account in determining the fair return in that case. I&M's rates are, and will remain, significantly below Duke Indiana's rates and I&M's customer satisfaction is also high. See Exhibit HJM-R2 and witness Murray rebuttal testimony at 31-33. This too highlights the reasonableness of the return reflected in the Settlement Agreement.

³ As stated in Dr. Avera's rebuttal testimony (at 41-42), I&M's original proposal reflects a return on fair value of 4.93%; the proposals of the OUCC and the Industrials reflected a return on fair value rate base of 4.32% and 4.51%, respectively.

⁴ For example, fifteen years ago, in Cause No. 39314, the Commission authorized a 4.5% fair return on I&M's fair value rate base as determined by the Commission. More recently, in Cause No. 42359, the Commission approved a 5.51% fair return on Duke Indiana's fair value rate base.

Q. How does the Settlement Agreement address off system sales ("OSS") margins?

A. OSS margins are the revenues I&M is allocated from certain non-firm wholesale sales and other transactions made by the Commercial Operations business unit of American Electric Power Company, I&M's parent company. The Settlement Agreement provides that the revenue requirement used to establish basic rates includes a credit of \$37.5 million of OSS margins allocated to the Indiana retail jurisdiction. Indiana retail jurisdictional OSS margins above this amount will be fairly shared between customers and the Company. More specifically, retail jurisdictional OSS margins between \$37.5 million and \$90.0 million will be shared on a 50/50 (Company/customer) basis and OSS margins above \$90.0 million will be shared on a 60/40 (Company/customer) basis. The initial factor set under the OSS margins sharing mechanism will include as a credit \$25.055 million of the customers' share of projected OSS margins. The OSS margins sharing mechanism will be adjusted annually.

These provisions reflect compromise and balance the interests of customers and the Company while recognizing the volatile nature of OSS margins and the unique circumstances presented in this case. As reflected in the testimony submitted in the case, the test year levels of OSS margins achieved by I&M are significantly greater than test year levels of OSS margins considered in past Commission proceedings.⁵

⁵ For example, in I&M's last rate case, the Commission order embedded \$16 million of OSS margins as a credit to the revenue requirement. I&M Witness Tierney Direct at 19. (The total Company test year margins at the time were \$21 million, of which \$16 million was allocated to the retail jurisdiction). In

1 The Parties had varying positions regarding the ratemaking treatment for OSS
 2 margins. For example, I&M had proposed that OSS margins should be
 3 recognized solely in the OSS margins sharing mechanism. Under I&M's
 4 proposal, the customers and the Company would have shared OSS margins on a
 5 50/50 basis provided that the customers' share of OSS margins reflected in the
 6 rate adjustment mechanism would be at least \$20 million. This minimum credit
 7 was substantially greater than the minimum credit recognized in previous Indiana
 8 rate cases. See rebuttal testimony of witness Tierney at 34-35. In contrast, the
 9 Industrials proposed that the revenue requirement used to establish basic rates
 10 should include a minimum credit in the amount of either \$96 million or \$72 million
 11 with the Company's opportunity to share in the OSS margins limited to margins in
 12 excess of the \$96 million. See testimony of Industrials witness Selecky at 18.
 13 The testimony submitted by the OUCC reflected a position that was between I&M
 14 and the Industrials. The OUCC proposed that the revenue requirement used to
 15 establish basic rates should include a credit in the amount of approximately \$37
 16 million and sharing should be done through a separate rate adjustment
 17 mechanism. OUCC witness Satchwell at 17, 21; witness Catlin at 8. I&M
 18 submitted rebuttal testimony that explained why I&M believed the OUCC's and
 19 Industrials' positions were inconsistent with the Commission's prior orders and
 20 could adversely affect both customers and the Company. See rebuttal testimony

Duke Indiana's recent rate case (Cause No. 42359), approximately \$14.7 million net OSS margins were embedded in the revenue requirement. Tierney Rebuttal at 33. In the Commission's 1995 Order regarding Southern Indiana Gas & Elec. Co., Cause No. 39871, approximately \$1 million of OSS margins were embedded in the revenue requirement. The more recent settlement agreement approved in the Vectren South Order embedded \$10.5 million in the revenue requirement. This was a reduction from the test year level. By comparison, in I&M's current case, the performance of the Commercial Operations produced test year OSS margins of \$96 million. This level of OSS margins is six times greater than the level of OSS margins the Commission found was not sufficiently material to warrant tracking in I&M's last rate case.

1 of witness Tierney at 26-37. For example, I&M's testimony provided additional
 2 information regarding the volatility of the wholesale markets and explained I&M's
 3 view that the OUCC's and Industrials' proposals were unreasonable when the
 4 proposed credit is viewed as a percentage of I&M's authorized NOI or compared
 5 to the revenue requirement credits reflected in other Commission decisions.
 6 I&M's testimony also explained I&M's view that the OUCC's and Industrials'
 7 proposals failed to properly recognize the integrated nature of the Commercial
 8 Operations organizations and the benefits derived from that structure.

9 As explained in the direct testimony of I&M witness Tierney and I&M witness
 10 Bradish, participation in today's wholesale electricity and energy trading market
 11 involves risk and provides opportunities far beyond those available in the past.
 12 I&M incurs costs and risks whenever it engages in the wholesale market through
 13 its parent company. Without a tangible opportunity to retain a significant portion
 14 of the OSS margins, a rational utility would focus on meeting the needs of its
 15 retail customers but would not necessarily take on the incremental costs and
 16 risks necessary to maximize opportunities in the wholesale electricity market as
 17 Commercial Operations has done.

18 The Settlement Agreement essentially reflects the OUCC's moderate proposal
 19 regarding the treatment of OSS margins, with two additions. First, to resolve the
 20 issue of how to recognize the costs incurred by Commercial Operations in
 21 producing these results, the Parties agreed to share the \$1 million estimate of
 22 this expense developed by OUCC witness Satchwell. To do so, the OSS
 23 margins credit included in basic rates was increased by \$0.5 million to offset the

costs reflected in I&M's expenses. Second, to encourage I&M to strive for results in excess of those forecasted, I&M's share of the margins above \$90.0 million is increased by ten percentage points.

In I&M's view, the Settlement Agreement recognizes the volatile nature of the wholesale market and the Commercial Operations' activities that extend beyond any obligation I&M has as a retail utility. Under the Settlement Agreement, customers will receive the benefit of approximately \$62.5 million of OSS margins during the first year the new rates are in effect.⁶

This result is consistent with the Commission's decisions regarding the ratemaking treatment of OSS margins. In the Duke Indiana Order, the Commission stated "that balancing the interests of [Duke Indiana] and its ratepayers is appropriate and, if done properly, will provide a benefit that might not otherwise be possible." Duke Indiana Order at 116. The Settlement Agreement is also consistent with the Commission's order in I&M's last rate case. There, the Commission indicated that it would be appropriate to track OSS margins if they were sufficiently material and that a change in OSS margin levels could significantly harm the utility's financial health. *Re Indiana Michigan Power Company*, Cause No. 39314 (IURC 11/12/93) at 168.⁷ As also explained in the

⁶ \$37.5 million is reflected in the revenue requirement used to establish basic rates. \$25.055 is the initial credit reflected in the OSS margins sharing mechanism.

⁷ The order in I&M's last rate case was a litigated decision. It addressed the ratemaking treatment of OSS margins and was entered in 1993. The Duke Indiana Order is the most recent litigated rate proceeding where the ratemaking treatment of OSS margins was addressed by the Commission. While the Vectren South Order is more recent (IURC 8/15/2007), that order approved a non-precedential settlement agreement. Information regarding the Vectren South Order is provided for purposes of completeness. During the past 15 years, the Commission also conducted rate proceedings regarding Indianapolis Power & Light Company (*Re Indianapolis Power & Light Co.*, Cause No. 39938 (IURC 8/24/95)) and Northern Indiana Public Service Company (*Re Northern Ind. Pub. Serv. Co.*, Cause No.

rebuttal testimony of witness Tierney (at 10), in the current case, the OSS test year margins amount of \$96 million represents almost 63% of the NOI set forth in the Settlement Agreement. This clearly demonstrates the materiality of I&M's OSS margins.

The chart below shows the OSS margins used as a credit in the ratemaking process as a percentage of the NOI established in the respective rate case. The Settlement Agreement in this case is also reflected in the chart below. As depicted on the chart, the credits reflected in past Commission decisions involving Vectren South, Duke Indiana and I&M ranged from 2.17% to 10.04%. Under the Settlement Agreement, the revenue requirement used to establish basic rates reflects an OSS margins credit of \$37.5 million. This is nearly 25% of the authorized NOI provided in the Settlement Agreement. Thus, the proposed treatment of OSS margins provided in the Settlement Agreement compares favorably with the Commission's prior decisions.

OSS Margins as a Percent of Authorized NOI

	Vectren South	Duke Indiana	I&M	
Order Year	1995	2004	1993	Settlement Proposal
Cause No.	39871	42359	39314	43306
OSS Margins / Authorized NOI	2.17%	5.51%	10.04%	24.59%*

* Based on proposed NOI

41746 (IURC 9/23/2007)). These matters were resolved by non-precedential settlement agreements and did not expressly address the ratemaking for OSS margins.

1 The sharing mechanism provided by the Settlement Agreement encourages I&M
2 to participate in the wholesale electricity market and incents the Company to
3 continue to take reasonable steps to optimize its Commercial Operations in this
4 area. This is consistent with the Duke Indiana Order at 112 (staff witness
5 Cvengros testified that an "explicit sharing mechanism provides a better incentive
6 to the utility to make economically efficient OSS as well as easier review and
7 monitoring of the shared profits.").

8 Because the market-based margins are shared under the Settlement Agreement,
9 both customers and the Company benefit. Customers receive a reduction to
10 their cost of retail service. The Company receives below-the-line compensation
11 to compensate it for incurring the risk of the activity. Thus, the sharing
12 mechanism provided in the Settlement Agreement aligns the interests of the
13 utility and its retail customers.

14 Importantly, the Settlement Agreement provides only for sharing *above* the \$37.5
15 million reflected as a credit to the revenue requirement. Thus, I&M customers
16 are protected from the downside loss but permitted to share in the upside benefit.
17 This ensures that I&M's risk of participating in the wholesale electricity market
18 remains with I&M and is not passed to customers. In stark contrast, the OSS
19 margins sharing mechanism applicable to Duke Indiana provides for sharing
20 above *and* below the amount used as a credit in the retail revenue requirement.
21 The Duke Indiana Order provides "[w]e also find that tracking should be above
22 and below the net amount in base rates [\$14.747 Million]; [Duke Indiana] may not
23 apply a net annual off-system sales profit of less than zero to the tracker." Duke

Indiana Order at 117.⁸ As reflected by the Commission orders, under the Duke Indiana sharing mechanism customer rates have increased due to Duke Indiana's OSS margins falling below the level credited to basic rates.⁹

Cause No.	Time Period	Net Jurisdictional OSS Margins	OSS Tracker Rate
42870 (6/28/06) (p. 7)	Twelve months ended 9/30/05	\$2.986 Million	\$5.881 Million Rate Increase
43074 (6/13/07) (p. 7)	Twelve months ended 9/30/06	\$9.722 Million	\$2.513 Million Rate Increase
43302 (5/28/08) (p. 9)	Twelve months ended 9/30/07	\$9.611 Million	\$2.568 Million Rate Increase

By comparison, and as shown in the chart below, under the Settlement Agreement, I&M customer rates may *decrease* due to changes in OSS margins above the \$37.5 million embedded in the revenue requirement but I&M customer rates cannot *increase* in the event OSS margins fall below this level.

⁸ For purposes of completeness, I would note that this is also the case for Vectren South. The Vectren South Order states that "[i]n approving the 50/50 sharing of non-firm wholesale power margins as part of the Settlement Agreement, the Commission finds that tracking shall be above and below the net \$10.5 million in base rates;" Vectren South Order at 32. Because the Vectren South Order was approved last year, the Commission has not yet entered decisions reflecting the actual implementation of the Vectren South annual sharing mechanism.

⁹ I present this comparison not to suggest that the Duke Indiana structure is unreasonable but to demonstrate the differences negotiated in the overall settlement agreement in I&M's case.

1

Total OSS Margins	Customers Share of OSS Margins	I&M Share of OSS Margins	OSS Tracker Rate
\$95 Million	\$65,750,000	\$29,250,000	\$28.250 million rate decrease
\$80 Million	\$58,750,000	\$21,250,000	\$21.250 million rate decrease
\$37.5 Million	\$37.5 Million	0	0
\$20 Million	\$37.5 Million	(\$17.5 Million)	0
\$10 Million	\$37.5 Million	(\$27.5 Million)	0
Zero	\$37.5 Million	(\$37.5 Million)	0

2

3 Thus, the balancing of risk and reward under the Settlement Agreement is
4 strikingly different from other OSS sharing mechanisms used in Indiana. As
5 discussed below, this difference is balanced by other provisions of the Settlement
6 Agreement, namely the treatment of OSS margins for purposes of the "earnings
7 test" in I&M's fuel cost proceedings. In this way, the Settlement Agreement
8 compensates the Company for the additional risk while also providing the
9 Company an incentive to engage in the broader OSS activities which have
10 produced the OSS margins at issue in this case.

1 **Q. Industrials witness Dauphinais and OUCC witness Satchwell raised an**
2 **issue regarding the treatment of Financial Transmission Rights (“FTR”)**
3 **revenues to which witnesses Tierney (at 37) and Ondayko (at 10-13)**
4 **responded in their rebuttal testimony. How is this issue resolved in the**
5 **Settlement Agreement?**

6 **A.** The FTR issue was one of the more complicated issues to negotiate.
7 Accordingly, it is worth a moment to describe the nature and operation of FTRs.
8 As discussed in the testimony of I&M witness Bradish, FTRs are essentially
9 financial contracts that entitle the holder to rebates of congestion charges and
10 are used to offset the congestion costs incurred in the transmission of electricity
11 to customers. As such, AEP allocates FTRs to OSS in the wholesale market
12 (“OSS FTRs”) and retail jurisdictional sales made to I&M’s Indiana customers by
13 I&M as a Load Serving Entity (“LSE”) (“LSE FTRs”).

14 I&M proposed accounting for all FTRs, net of congestion charges, in the OSS
15 margins sharing mechanism. The OUCC submitted testimony which took the
16 position that customers should be “made whole” by using FTR revenues to fully
17 offset LSE transmission congestion costs before any FTR revenues are allocated
18 to OSS. I&M did not agree with this view in its rebuttal testimony.

19 The Settlement Agreement resolves this issue by providing that FTR revenues
20 associated with OSS activities and associated transmission congestion costs will
21 be accounted for in margins under the OSS margins sharing mechanism. LSE
22 FTR revenues and associated transmission congestion costs will be included in
23 the PJM Tracker. However, to the extent that LSE FTR revenues are greater

than associated transmission congestion costs, such net LSE FTR revenues will be accounted for and shared under the OSS margins sharing mechanism. If LSE transmission congestion costs exceed LSE FTR revenues, OSS FTR revenues will be used first to make up any such deficiency on an annual basis before any allocation to the OSS margins sharing mechanism.

Q. Please explain how the Settlement Agreement treats the Company's share of OSS margins and FTR revenues, net of congestion charges, for purposes of IC 8-1-2-42(d)(3) and IC 8-1-2-42.3.

A. To make the Company's sharing opportunity under the Settlement Agreement meaningful, the Settlement Agreement provides that I&M's share of OSS margins and net FTR revenues under the OSS margins sharing mechanism will be excluded from the earnings test in determining I&M's compliance with the provisions of IC 8-1-2-42(d)(3) and IC 8-1-2-42.3 for a period of four (4) years from the effective date of the new rates established in this proceeding. After this provision expires, the Settlement Agreement provides that the Parties are free to address this issue again. I&M's sum of differentials, commonly referred to as the "earnings bank" computed under IC 8-1-2-42.3, shall not be re-set in this case.

This approach is administratively simple and transparent. It permits the Commission to fully monitor OSS margins. This provision also recognizes that if the Commission approves the OSS margins sharing provided in the Settlement Agreement, I&M should not lose its "share" through the application of the earnings test in the FAC proceedings. In other words, this provision of the Settlement Agreement is necessary to give effect to the sharing and balancing of

1 risk and reward described above.¹⁰ Absent this provision, the earnings test
2 applied in the fuel adjustment clause ("FAC") could have the "clawing back" effect
3 of refunding I&M's "share" of the OSS margins to customers.

4 This provision of the Settlement Agreement also recognizes that I&M's sharing
5 mechanism differs from the sharing mechanism used by other Indiana utilities in
6 that I&M's sharing mechanism will apply *only* to margins *above* the \$37.5 million
7 embedded in the revenue requirement. Furthermore, this provision implicitly
8 recognizes the large capital needs, environmental risks and other challenges
9 facing I&M. While the Company benefits from being a member of the AEP
10 System, the fact remains that I&M is about half the size of Indiana's largest
11 electric utility and must be able to maintain its financial health.

12 This settlement provision also recognizes that I&M does not have a large "bank"
13 of under-earnings because the "bank" was reset following the decision in Cause
14 No. 43231.¹¹ While I&M's sum of differentials as of I&M FAC 61 is not zero, it is
15 significantly less than it was previously and less than the sum of differentials for
16 other Indiana electric utilities. As a result, this settlement provision appropriately
17 maintains the balance of risk and reward established by the overall sharing
18 mechanism provided by the Settlement Agreement, consistent with the
19 underlying statute and the order in Cause No. 43231. While the Settlement
20 Agreement reflects I&M's proposal in this regard, it is important to note that this

¹⁰ As noted in the rebuttal testimony of witness Curry (at 2), this treatment is consistent with the handling of the shareholder share of the AEP/CSW merger savings approved by the Commission's order dated April 26, 1999 in Cause No. 41210 (at 8).

¹¹ I&M Witness Murray HJM-R4 page 1 shows I&M's sum of differentials calculation before it was reset by the Commission order in Cause No. 43231 totaled (\$930,691,000) and page 2 of this exhibit shows the calculation following this decision as of I&M's FAC61 is (\$156,451,000).

1 treatment is limited to a period of four (4) years. This limitation on the exclusion
2 of OSS margins from the "earnings test" reasonably balances the varying
3 positions regarding this issue.

4 The sharing provided under the Settlement Agreement balances the risk/reward
5 relationship while also recognizing the volatility inherent in the wholesale market.
6 Simply put, customers benefit because the sharing mechanism encourages the
7 Company to optimize OSS margins. By encouraging optimization of OSS
8 margins, the Settlement Agreement helps enable I&M to continue maintaining
9 lower rates and this benefits our customers. I&M and shareholders benefit
10 because optimizing OSS margins helps maintain the financial health of the
11 Company and improve total earnings. While the minimum credit reflected in the
12 revenue requirement is larger than the credit proposed by I&M, it is significantly
13 less than the test year level of \$96 million.¹² As explained in the testimony of
14 witnesses Satchwell (p. 17) and Catlin (p. 8), the credit proposed by the OUCC to
15 basic rates of \$37.043 million approximates the Indiana retail jurisdictional
16 portion of the lowest OSS margins level achieved since 2000. While historical
17 experience does not reflect current market conditions, unit availability and other
18 uncertain factors, I&M was willing to agree to this provision as part of the overall
19 settlement package. Embedding \$37.5 million OSS margins as a credit to the
20 revenue requirement rather than the test year level of OSS margins reduces the

¹² This \$96 million represents the Indiana retail jurisdictional share of total Company OSS margins using the MLR reflected in I&M's case-in-chief. As reflected in Section 6 of the Settlement Agreement, OUCC witness Satchwell proposed a different MLR, which was accepted for settlement purposes provided it is applied to all related adjustments, including OSS margins. When the agreed upon MLR is applied to test year OSS margins, the retail jurisdictional amount is \$94.1 million.

1 risk to the Company's financial stability in the event the Company experiences a
2 decrease in its OSS margins levels.

3 **Q. Does the Settlement Agreement provide for continued prudent risk**
4 **management?**

5 A. Yes. I&M's direct testimony provided the Commission and the other Parties with
6 significant information demonstrating that we use sound risk management
7 policies and practices to actively manage risk and safeguard the Company and
8 its customers from the Commercial Operations activities in the non-firm
9 wholesale electricity market. *E.g.* Bradish Direct, at 20-23; *Tr.* C-21-24; C-83-87;
10 C120, 127; D-7-12, 16-31; Petitioner's Exhibit Redirect 1. On June 6, 2008, I&M
11 provided additional information on market risk management in response to the
12 Commission's May 27, 2008 docket entry.¹³ The testimony submitted by the
13 other Parties did not raise any issues regarding I&M's risk management.

14 In my view, the balanced treatment of OSS margins provided by the Settlement
15 Agreement is important not only because it encourages the Company to continue
16 to optimize its OSS, but also because it permits the Company to continue its
17 prudent risk management activities.

18 Simply put, the balance reflected in the Settlement Agreement recognizes that
19 sometimes the best optimization decision is knowing when to stay out of the
20 market and wait for the right opportunity. By limiting the percentage of I&M's NOI

¹³ This response included over 360 pages of additional details, including: current and past market risk policies and explanations for revisions thereto, information regarding market data sources, examples of hedge strategies and procedures applicable to hedging, information regarding credit risk management, and information regarding the integrated nature of Commercial Operations.

that is dependent on the OSS margins, the Settlement Agreement does not create a need for Commercial Operations to be overly aggressive in trying to match or exceed test year OSS margins just to provide the Company a fighting chance to earn its Commission-authorized NOI.

As explained in the rebuttal testimony of witness Tierney (p. 40), customers want strict risk management procedures in place because a smaller, more steady credit from OSS margins is vastly preferable to no credit at all. In contrast, shareholders want strict risk management procedures in place, because, while they share equally in the upside of OSS margins, they retain the responsibility for any downside. In this way, the OSS margins provisions in the Settlement Agreement balance risk and reward and permit continued prudent risk management of OSS activities.

Q. How does the Settlement Agreement address I&M's other proposed rate adjustment mechanisms (commonly referred to as "trackers")?

A. As discussed by the Commission in its 2007 Flexibility Report, Electricity Report (at 14), "[t]rackers, in the abstract, are neither inherently good nor bad."

The Settlement Agreement provides for a PJM Tracker, an Environmental Tracker for emission allowance costs and a Demand Side Management and Energy Efficiency ("DSM/EE") Tracker. These trackers recognize costs that are variable or volatile in amount from year to year, variable as to timing, costs that are mandated or encouraged by governmental law or regulation, or outside the control of the Company. These trackers recognize costs that are included in similar trackers approved by the Commission for other electric utilities.

1 Witnesses Soller and Curry provide more details on the mechanics and timing of
2 each tracker.

3 **Q. How do the rate adjustment mechanisms provided by the Settlement**
4 **Agreement compare to tracking mechanisms approved for other Indiana**
5 **utilities?**

6 A. The Settlement Agreement provides for less tracking than I&M originally
7 proposed and in this regard is responsive to the Industrials' concern that tracking
8 mechanisms be kept to a minimum. As illustrated by I&M witness Roush Exhibit
9 DMR-1 and DMR-2, the tracking originally proposed by I&M was more limited as
10 a percentage of a customer's total bill than similar mechanisms that have been
11 approved by the Commission for other Indiana utilities. Because the Settlement
12 Agreement includes even less tracking, it is significantly more limited as a
13 percentage of a customer's total bill than previously approved mechanisms.

14 As shown by witness Roush's rebuttal testimony (pp. 2-3) currently about 92% of
15 a 1,000 kWh residential customer's bill is reflected in I&M's basic rates. Under
16 the initial rates provided in the Settlement Agreement, customers will be charged
17 about 98% of their costs through I&M's basic rates and approximately 2%
18 through rate adjustment mechanisms. By comparison, other Indiana electric
19 companies track 17% to 24% of their respective monthly bills. See witness
20 Roush rebuttal, at 3. The percentage of tracking proposed under the Settlement
21 Agreement is significantly more limited as a percentage of a customer's total bill
22 than those previously-approved mechanisms. Thus, the level of costs that I&M
23 would be permitted to track under the Settlement Agreement is not unreasonable

when compared to the total I&M electric bill or to costs recognized by other Indiana utilities through trackers. Because I&M's rates will remain low, even when the trackers provided by the Settlement Agreement are taken into account, and the percentage of the bill tracked will remain comparatively small, the adoption of the tracking mechanisms is reasonable and should not adversely affect customers' ability to manage their electric costs. See rebuttal testimony of witness Murray at 18.

Q. Are the rate adjustment mechanisms provided by the Settlement Agreement important to I&M?

A. Yes. While the tracking that I&M will implement under the Settlement Agreement is more limited than tracking utilized by other companies, the implementation of these tracking mechanisms is just as important to I&M. The rate adjustment mechanisms provided in the Settlement Agreement should help maintain I&M's financial stability and improve the Company's opportunity to earn its authorized return. As explained in the rebuttal testimony of witness Fetter (at 8-11, 16-19), credit rating agencies view tracking mechanisms favorably. It is important to maintain I&M's credit ratings to permit I&M to access capital markets on a timely basis and on reasonable terms.

Q. In his testimony, OUCC witness Satchwell suggested that an analysis of the benefits of the AEP Interconnection Agreement would be appropriate. Is this addressed in the Settlement Agreement?

A. Yes. The Settlement Agreement (p. 5) provides that I&M will work with the OUCC and other interested Parties to analyze the effectiveness and customer

1 benefits of the AEP Interconnection Agreement. This work will be done during
2 2009.

3 **Q. Please discuss the Tracker Participation Payment in the Settlement**
4 **Agreement.**

5 A. The Settlement Agreement provides that I&M will make a lump sum payment in
6 the amount of \$150,000 to the Industrials to offset costs that may be incurred by
7 the industrial customers' participation in the proceedings to administer the
8 trackers approved under the Settlement Agreement. From I&M's perspective,
9 the timely cost recovery provided by these trackers is important and the annual
10 reconciliation process is intended to permit the trackers to be administered in a
11 more efficient manner than could be achieved under a quarterly process. That
12 said, I&M also recognizes that the inclusion of the tracking mechanisms in the
13 Settlement Agreement reflects compromise on the part of the Industrials and that
14 because of the magnitude of their energy use, industrial customers are
15 particularly interested in having an opportunity to scrutinize the adjustments
16 provided by trackers. We also recognize that the current economic conditions
17 have affected all of our customers, particularly industrial customers. I&M
18 recognizes that our industrial customers are also major employers and an
19 important part of Indiana's economy. This is another reason I&M considered the
20 level of support for the Industrials' participation in tracker proceedings to be
21 reasonable as part of the overall settlement package.

22 **Q. How does the Settlement Agreement resolve the issue regarding nuclear**
23 **decommissioning expense?**

1 A. First, it should be kept in mind that this expense does not fall to the bottom line
 2 for I&M because I&M simply collects the authorized amounts and transfers them
 3 into external trust funds. The funds are held in trust for the eventual
 4 decommissioning of the Cook Nuclear Plant and are not available to the
 5 Company for any other purpose. Thus, because today's customers are
 6 benefiting from the low cost energy provided to them from the Cook Nuclear
 7 Plant, it is incumbent for them to pay their fair share of the funds collected for its
 8 eventual decommissioning.

9 In I&M's case-in-chief, I&M witness Knight presented a study showing that the
 10 projected cost of decommissioning for the Cook Nuclear Plant ranges anywhere
 11 from \$733 million to \$1.281 billion in 2006 dollars. I&M witness Kiser proposed
 12 that the \$18.7 million annual provision for nuclear decommissioning expense
 13 recognized in Cause No. 39314 remains appropriate and should be maintained.
 14 Kiser Direct at 3-4. In his view, maintaining this level of funding was reasonable
 15 given the uncertainties of both future decommissioning costs and the
 16 performance of the investment markets.

17 OUCC witness Catlin provided an analysis which in his view showed that
 18 continued funding at the \$18.73 million as proposed by I&M will lead to the
 19 further build-up of decommissioning funds that may not be needed. Catlin Direct
 20 at 17. Industrials witness Selecky reached the conclusion that since the nuclear
 21 operating license for the Cook Nuclear Plant has been extended 20 years, the
 22 need for continued contributions to the decommissioning fund is reduced.
 23 Selecky Direct at 6. These Parties also challenged the assumptions regarding

1 inflation rates and the cost contingency reflected in I&M's analysis. Witness
 2 Catlin (Schedule TSC-3, p. 1) proposed annual nuclear decommissioning
 3 expense of \$11.5 million should be recognized in the ratemaking requirement.
 4 Witness Selecky's view was that annual nuclear decommissioning expense
 5 should be zero.

6 In his rebuttal testimony, I&M witness Kiser (p. 2) contended that witness Catlin's
 7 approach was overly simplified in that it was based on a single decommissioning
 8 scenario, ignoring all other possible sets of circumstances and did not allow for
 9 any variation in the rate of return on investments. Witness Kiser explained that
 10 given the long time spans and large dollar amounts involved, slight variations in
 11 assumptions can result in major misestimations. Kiser Rebuttal at 3. Witness
 12 Kiser disagreed with the concerns about his inflation rate assumption raised by
 13 the OUCC and Industrials witnesses. In particular, he explained it is important to
 14 consider a range of assumptions. Witness Kiser expressed his belief that
 15 presenting a range of possible inflation rates gives a better indication of the
 16 possible dollar amounts in the resulting decommissioning expense and the
 17 possible overall decommissioning costs caused by the variability of individual
 18 components such as energy costs and radioactive waste disposal. Kiser
 19 Rebuttal at 12.

20 The Settlement Agreement provides that I&M should be authorized on an Indiana
 21 retail jurisdictional basis to collect \$8.1 million annually for the decommissioning
 22 of the two units of the Cook Nuclear Plant. This expense level is within the range
 23 of estimates presented by the various witnesses who testified on this subject.

1 From I&M's perspective, the Settlement Agreement reflects compromise that
2 balances the interests of today's customers and those of tomorrow, while
3 recognizing that the annual funding requirement for the Cook Nuclear Plant
4 decommissioning trust should provide sufficient assurance that the plant can be
5 safely decommissioned at the end of its planned useful life.

6 **Q. Please discuss the provision in the Settlement Agreement that provides for**
7 **certain language to be included in the Commission's order in this Cause.**

8 A. In the Settlement Agreement, the Parties have also agreed that the Commission
9 order in this Cause should include certain language necessary to assist I&M in
10 complying with regulations of the Internal Revenue Service regarding qualified
11 nuclear decommissioning trust funds. The Commission order in I&M's last rate
12 case (at 129-130) also incorporated such language for this same purpose.

13 **Q. Please discuss the other provisions in the Settlement Agreement regarding**
14 **the nuclear decommissioning trust.**

15 A. The Settlement Agreement includes two (2) other provisions related to the
16 nuclear decommissioning trust. These provisions provide relief sought in I&M's
17 case-in-chief that were not challenged in the testimony presented by the other
18 Parties. First, the Settlement Agreement provides that the investment restrictions
19 for the nuclear decommissioning trust funds shall be modified so that they apply
20 to the portfolios as a whole. More specifically, the Settlement Agreement
21 modifies the restrictions so that (a) the quality ranking of the equity portfolio must
22 be B+ or greater; and (b) the fixed income portfolio must have a credit quality of
23 AA or higher, as recommended by I&M witness Kiser. This will provide I&M with

1 greater diversification opportunities while retaining important safeguards
2 necessary for the vitality of the trust fund.

3 Second, the Settlement Agreement provides for the continuation of the flexible
4 funding plan. The flexible funding plan is summarized in witness Kiser Exhibit
5 JSK-2 and discussed in his direct testimony at 36. The flexible funding plan was
6 first approved in Cause No. 38702-FAC33. As explained in witness Kiser's
7 testimony, it was continued in subsequent Commission orders, the most recent
8 being Cause No. 38702-FAC61.

9 **Q. Do you have any other comments regarding the nuclear decommissioning**
10 **trust funding?**

11 A. Yes. In his direct testimony, I&M witness Kiser also indicated that I&M will
12 continue to monitor the funding level and report to the Commission every three
13 years. Kiser Direct, at 33. While the Parties did not expressly provide for this
14 reporting in the Settlement Agreement, it is I&M's intention to continue providing
15 this report to the Commission.

16 **Q. Please discuss the Settlement Agreement provisions regarding I&M's**
17 **Economic Development Program.**

18 A. I&M witness Moorman Rowe testified in support of a comprehensive Economic
19 Development Program, which would include, among other things, the restoration
20 of an economic development rider, establishment of an economic development
21 grant fund, increased support to local economic development organizations, and
22 research and marketing. Moorman Rowe Direct at 9. Witness Moorman Rowe
23 explained that the Economic Development Program will allow I&M to support

1 business development opportunities within I&M's service area and benefit state
2 and local economies by enhancing economic activity and creating jobs.
3 Moorman Rowe Direct at 9.

4 OUCC witness Catlin accepted less than all of the program costs based on his
5 view that the proposal was not adequately supported by formal research and
6 analysis to determine the specific needs of local, regional and state economic
7 development organizations and what resources are already available. CAC
8 witness Smith opposed the economic development program based on his view
9 that such programs are not "utility service."

10 In response, South Bend Mayor Stephen J. Luecke submitted testimony
11 explaining the importance of the program from his perspective and
12 recommended that the Commission approve the amount requested by I&M.

13 In her rebuttal testimony, witness Moorman Rowe explained that thorough
14 research had been conducted and based on her experience, as well as the
15 experience of I&M's two certified economic developers, spending money on more
16 analysis is not reasonably calculated to produce benefits that outweigh the cost
17 of the research.

18 Ms. Moorman Rowe also provided additional clarification regarding the proposed
19 programs goals and components. Witness Murray disagreed with witness Smith
20 and expressed her view that the test should be whether the economic
21 development program costs are reasonably necessary, appropriate and not
22 excessive. Witness Rowe also explained that the proposed program

1 components and costs are reasonable investments necessary to revitalize
 2 electric utility services within I&M's service area; that financial support for
 3 economic development has been the custom and practice of I&M and the
 4 enhanced support for existing economic development organizations is a good
 5 way to address the need to attract, retain and expand existing industry in I&M's
 6 service area. Witnesses Moorman Rowe and Murray (at 40-41) also explained
 7 that I&M has been experiencing a decline in industrial customers and growth in
 8 other customer segments has fallen to less than 1% annually. From I&M's
 9 perspective the expanded economic development support is particularly
 10 reasonable in light of the customer decline in I&M's service area. Efforts to
 11 reverse this decline are reasonable and necessary because they may maintain, if
 12 not improve, the base over which I&M's fixed costs may be spread, which
 13 benefits all customers.

14 The Settlement Agreement provides that I&M's proposed economic development
 15 program will be approved and the revenue requirement used to establish basic
 16 rates in this proceeding includes \$564,349 to reflect the Indiana jurisdictional
 17 portion of the \$722,000 of expense related to the program. The relevant exhibit
 18 in I&M's case-in-chief filing is Exhibit F-4 (O&M Expense Adjustment No. 26).

19 The inclusion of the economic development program costs is consistent with the
 20 policy of the State of Indiana to encourage utilities to support the economic
 21 development goals of the State. The Commission has recognized economic
 22 development program costs for ratemaking purposes in previous cases.

1 **Q. Did the Settlement Agreement resolve other issues regarding the rate**
2 **increase and associated matters?**

3 A. Yes. As discussed in the supplemental testimony of witness Curry, the
4 Settlement Agreement contains provisions concerning: Member Load Ratio;
5 Nuclear Regulatory Commission fees; major storm damage expense; pension
6 and Other Post Employment Benefit Expense ("OPEB"); prepaid pension
7 contribution; amortization of New Source Review Settlement, deferred OPEB
8 costs and rate case expense; nuclear fuel inventory; and I&M's tariffs, rules and
9 regulations.

10 **Q. How does the Settlement Agreement address cost-of-service and rate**
11 **design issues?**

12 A. As the Commission is aware, the Parties were able to reach an agreement in
13 principle regarding the revenue issues by December 1, 2008 and requested the
14 opportunity to reduce these matters to writing and to further negotiate a
15 resolution of the cost-of-service and rate design issues. The Commission
16 released the Parties from the scheduled evidentiary hearing to permit the Parties
17 to continue negotiations. From the time we left the hearing room on the morning
18 of December 1st to late in the afternoon on December 4th, many hours were spent
19 in negotiations, with all Parties seriously committed to resolving differences, if
20 possible. Ultimately, we were able to bridge the issues and find a compromise
21 acceptable to all Parties regarding the allocation of the revenue increase to and
22 among the customer classes. I&M much appreciates the time invested by all
23 Parties in the final week of negotiations because it permits a comprehensive
24 resolution of this case to be presented to the Commission for its consideration.

1 The testimony submitted by I&M witness Roush, Industrials witness Phillips and
 2 Fort Wayne witness Heid reflected that the Parties these witnesses represent
 3 had relatively few but significant disagreements regarding cost-of-service and
 4 rate design. These Parties generally accepted I&M's jurisdictional cost-of-service
 5 study which utilized a 12 coincident peak ("CP") methodology and its class cost-
 6 of service study which utilized a 6 CP methodology and reflected a 50% subsidy
 7 reduction. OUCC witness Swan proposed that the peak and average
 8 methodology be utilized for the class cost of service study and accepted a 50%
 9 subsidy reduction provided his methodology be utilized. Thus, the evidence
 10 submitted by the Parties reflects significant differences between the OUCC and
 11 the other Parties who presented testimony on this issue. Because of this
 12 difference, the Parties agreed to use a common basis to frame the discussion of
 13 potential outcomes rather than attempting to reach agreement regarding the
 14 methodology to be used to reach the acceptable result.

15 Accordingly, under the Settlement Agreement the agreed revenue requirement
 16 should be allocated to and among I&M's customer classes based on I&M's
 17 methodology modified to reflect a 25% subsidy reduction and the allocation of
 18 certain costs included in the PJM Tracker on an energy basis. The allocation of
 19 the rate increase among the customer classes is reflected in Exhibit KDC-S1,
 20 included with witness Curry's testimony in support of the Settlement Agreement.
 21 Importantly, the reference to I&M's methodology is solely for purposes of
 22 explaining the rates produced under the Settlement Agreement. While the
 23 Parties agree that the agreed cost allocation yields just and reasonable rates, the
 24 Settlement Agreement also provides that no Party, by entering into the

Settlement Agreement, has acquiesced in or waived any position with respect to the appropriate methodology for determining cost-of-service or rate design. The Parties reserve all rights to present evidence and advocate positions with respect to cost of service and rate design issues in all other proceedings, including future I&M rate proceedings.

Finally, the agreed resolution described above made it unnecessary for the Parties to resolve the issue regarding the use of minimum system study for purposes of this case. The Settlement Agreement provides that at the time of its next general rate proceeding, I&M will perform a minimum system study and provide a copy of the study to the Parties.

Q. Does the Settlement Agreement provide for approval of I&M's tariffs?

A. Yes. The Settlement Agreement provides for approval of I&M's tariffs, including rules and regulations, consistent with the resolution of the identified disputes set forth in the Settlement Agreement. These items are discussed in the testimony of witness Curry.

Q. Please discuss the provisions of the Settlement Agreement regarding Alternate Feed Service ("AFS").

A. AFS is a premium service offered by I&M to customers who seek to enhance the reliability of service to their critical facilities by reserving capacity on a second circuit capable of feeding their load in the event the first circuit is not available. I&M must consider when planning its operations that the reserved capacity will be dedicated to the AFS customer and thus not be available for use to serve other customers. As such, I&M proposed a tariff to set the charges, terms and

1 conditions for AFS. The City of Fort Wayne opposed certain aspects of the AFS
2 Rider.

3 The Settlement Agreement provides that Fort Wayne agrees to withdraw its
4 opposition to I&M's proposed AFS Tariff in consideration of changes agreed to
5 be made to the proposed tariff. All Parties agree to approval of I&M's proposed
6 AFS Tariff. The five (5) existing AFS services being provided to Fort Wayne will
7 be included in the "grandfathering" proposed in this case until the circuits on
8 which capacity is reserved for the AFS service become capacity deficient. As a
9 result of the "grandfathering," I&M will not charge Fort Wayne a monthly capacity
10 reservation demand charge for AFS until the I&M substation equipment or
11 distribution circuit becomes "capacity deficient" and, as a result, I&M must incur
12 costs to modify or upgrade its common facilities to continue providing the AFS to
13 Fort Wayne. The Settlement Agreement clarifies that "capacity deficient" means
14 the capacity on the substation equipment or distribution circuit serving the
15 customer's AFS ("AFS circuit") is projected, according to good engineering
16 practice, to be insufficient to reliably serve the current and reasonably projected
17 load on the AFS circuit without effecting upgrades or modifications of the AFS
18 circuit within a reasonably foreseeable time period.

19 The Settlement Agreement also provides that the demand charge proposed by
20 I&M in its case-in-chief will be adjusted to conform to the revenue requirement
21 agreed upon in the Settlement Agreement. Thus, under the Settlement
22 Agreement, the final AFS demand charge is \$2.304 per kW/Kva, a slight
23 reduction from the \$2.333 per kW/Kva as originally filed.

I&M and Fort Wayne also disagreed whether the payments previously made by Fort Wayne to extend AFS facilities to Fort Wayne's sites included only local facilities or also included "system improvements." Without agreeing as to which position is correct, I&M will credit \$52,237.50 (50% of the \$104,475 in dispute) to Fort Wayne's AFS accounts to be used to offset the application of the approved demand charge under the AFS Tariff once the charges become applicable in accordance with the grandfathering agreement described above.

Q. Please discuss the Settlement Agreement provision regarding the Commission's order in Cause No. 43231 pertaining to I&M's depreciation accounting rates.

A. The Commission's interim order dated June 13, 2007 in Cause No. 43231 established I&M's depreciation accounting rates. These depreciation rates were reflected in I&M's case-in-chief and no challenge to these rates was raised by the other Parties. Accordingly, in the Settlement Agreement the Parties expressly recognized that it is reasonable and appropriate for the Commission to finalize the interim order in Cause No. 43231 without change.

Q. In your opinion, is the Settlement Agreement in the public interest?

A. Yes. As discussed in my testimony and in the testimony of witnesses Soller and Curry, the Settlement Agreement provides a just and reasonable resolution of all matters pending before the Commission in this case. It reflects the significant give and take inherent in serious negotiations among a diverse group of interests. While the Settlement Agreement package is reasonable as a whole, the evidence in support of the Settlement Agreement explains the basis for the

rate increase and other elements of the settlement package so that the Commission may understand how each disputed issue was resolved and determine that the Settlement Agreement, as a whole, is amply supported by the evidence of record.

Additionally, as noted above, public policy favors settlements. This public policy is part of the overall public interest. Hence, in the context of settlement, the public interest appropriately includes consideration of the compromise inherent in the negotiation process, particularly where, as here, the Settlement Agreement results from a rigorous process and presents a balanced and comprehensive resolution of all the issues among all the Parties. Therefore, on behalf of all the Parties, we recommend that the Commission find the Settlement Agreement is reasonable and in the public interest and promptly enter an order approving the Settlement Agreement in its entirety.

Q. The Settlement Agreement provides that time is of the essence and requests prompt Commission consideration and approval. How important is this provision to the Company?

A. As recognized in the Settlement Agreement language, a significant motivation for the Company to enter into the Settlement Agreement is the expectation that, if the Commission finds the Settlement Agreement is reasonable and in the public interest, an order authorizing the increase in I&M's rates and charges will be issued promptly by the Commission following such determination. While the Parties appreciate that the Commission has a responsibility to carefully consider the evidence of record to determine whether the Settlement Agreement is in the

1 public interest, all Parties urge the Commission to do so as soon as reasonably
2 possible.

3 This is a critical term in the Settlement Agreement from I&M's perspective. I&M
4 has agreed to a rate increase that is substantially less than originally proposed.
5 The Company has also agreed to rate adjustment mechanisms and sharing
6 provisions that differ substantially from I&M's proposal and subject the Company
7 to increased risk.

8 If the Parties had proceeded to litigation, the post hearing briefing process could
9 have extended into March 2009 or beyond. Under this schedule, a decision was
10 not expected until late Spring at the earliest and all Parties faced the risk and
11 delay associated with possible petitions for rehearing or reconsideration or
12 appeal. Commission approval of the Settlement Agreement by January 31, 2009
13 will permit the Company to place new rates into effect much sooner. In light of
14 the challenging economic conditions, particularly the matters addressed in the
15 rebuttal testimony of witnesses Hawkins, Avera and Fetter, the opportunity to
16 place new rates and tracking mechanisms into effect soon is extremely important
17 to the Company and its continued stability.

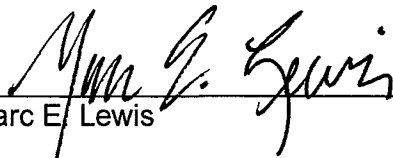
18 **Q. Does this conclude your prepared testimony?**

19 **A. Yes.**

VERIFICATION

I, Marc E. Lewis, Vice President of External Relations of Indiana Michigan Power Company, affirm under penalties of perjury that the foregoing representations are true and correct to the best of my knowledge, information and belief.

Dated: December 10, 2008.



Marc E. Lewis

INDIANA MICHIGAN POWER COMPANY

CAUSE NO. 43306

VERIFIED SUPPLEMENTAL TESTIMONY

IN SUPPORT OF SETTLEMENT

OF

KENT D. CURRY

**VERIFIED SUPPLEMENTAL TESTIMONY IN SUPPORT OF SETTLEMENT
OF KENT D. CURRY
ON BEHALF OF
INDIANA MICHIGAN POWER COMPANY**

1 **Q. Please state your name and business address.**

2 A. My name is Kent D. Curry. My business address is One Summit Square, P.O. Box
3 60, Fort Wayne, Indiana 46801.

4 **Q. By whom are you employed and in what capacity?**

5 A. I am employed by Indiana Michigan Power Company (I&M or Company) as its
6 Director of Regulatory Services.

7 **Q. Are you the same Kent D. Curry who previously filed direct and rebuttal
8 testimony in this proceeding?**

9 A. Yes, I am.

10 **Q. What is the purpose of your supplemental testimony in this proceeding?**

11 A. Together with the supplemental testimony presented by witnesses Soller and
12 Lewis, the purpose of my testimony is to support the Stipulation and Settlement
13 Agreement (Settlement Agreement) filed in this proceeding by all Parties. My
14 testimony focuses on the trackers and agreed upon adjustments to the revenue
15 requirement and attempts to provide a roadmap to assist the Commission in its
16 understanding of how the Settlement Agreement relates to the accounting
17 exhibits in I&M's case-in-chief.

18 **Q. On whose behalf are you testifying?**

19 A. I am testifying on behalf of I&M. While the Parties have reviewed and had an
20 opportunity to comment on the testimony I am providing prior to its filing, I note

1 that the other Parties may not agree with all opinions and explanations contained
2 in the testimony. My testimony does not change the substance of the Settlement
3 Agreement and I am authorized by all Parties to inform the Commission that all
4 Parties believe that: (a) the Settlement Agreement as a whole produces fair and
5 reasonable rates; (b) approval of the Settlement Agreement is in the public
6 interest; and all Parties (c) strongly encourage the Commission, after considering
7 the evidence in support of the Settlement Agreement, to find the Settlement
8 Agreement to be reasonable and in the public interest and promptly enter an
9 order approving the Settlement Agreement in its entirety.

10 **Q. Are you sponsoring any exhibits?**

11 A. Yes. Together with witnesses Soller and Lewis, I sponsor Joint Exhibit 1, which
12 is a copy of the Settlement Agreement. Joint Exhibit 1, includes Exhibit A to the
13 Settlement Agreement, which summarizes the overall rate increase.

14 I sponsor Exhibit KDC-S1, which shows the allocation of the agreed upon rate
15 increase to and among the customer classes. I also sponsor Exhibit KDC-S2,
16 which summarizes by pro forma adjustment the Company's net electric operating
17 income (NEOI) in its filing compared to the agreed upon amount reflected in the
18 Settlement Agreement and Exhibit KDC-S3, which shows the capital structure
19 and cost rates reflected in the Settlement Agreement.

20 **Q. How did the Parties arrive at the agreement regarding the revenue**
21 **requirement adjustments reflected in the Settlement Agreement?**

22 A. As reflected in the testimony of witness Lewis, the Parties discussed each of the
23 disputed adjustments, reviewed relevant data and negotiated a meaningful

1 compromise as part of an overall settlement package. The concessions reflected
2 in the Settlement Agreement increased I&M's adjusted pre-tax operating income
3 (and thus reduced required rate relief) by more than \$43 million and increased its
4 (after-tax) NEOI by over \$26 million (see Exhibit KDC-S2).

5 **Q. Do you have an exhibit that shows the capital structure and appropriate**
6 **cost rates reflected in the Settlement Agreement?**

7 A. Yes. This information is set forth in Exhibit KDC-S3.

8 **Q. How does the Settlement Agreement address I&M's proposed PJM**
9 **Tracker?**

10 A. In its case-in-chief, I&M proposed to implement a PJM Tracker for all PJM costs.
11 No PJM costs were embedded in the basic rates in I&M's original proposal. The
12 PJM Tracker was proposed because these costs are significant, volatile and
13 outside the control of the Company. The OUCC and Industrials challenged
14 various aspects of I&M's proposal. For example, the OUCC proposed that
15 certain PJM costs should be embedded in basic rates and others tracked and
16 proposed that certain PJM costs should be allocated on an energy basis. The
17 Industrials opposed tracking of PJM costs. On rebuttal, I&M noted that the
18 Commission has authorized other Indiana utilities to recover their RTO costs in a
19 timely manner through rate adjustment mechanisms.

20 In the Settlement Agreement, the Parties agreed that the revenue requirement
21 used to establish the basic rates agreed to in the Settlement Agreement includes
22 I&M's forecasted administrative costs related to I&M's membership in PJM. The
23 Settlement Agreement provides that I&M should be authorized to establish a

PJM Tracker to track costs related to its membership in PJM, including the variance from the forecasted administrative costs reflected in basic rates and the cost of PJM Regional Transmission Expansion Plan (RTEP) projects.

As also explained in the supplemental testimony of witness Lewis, I&M will offset transmission congestion costs with FTR revenues before allocating any FTR revenues to OSS on an annual basis. Transmission congestion costs for jurisdictional customers and FTR revenues to cover those expenses will be identified in the PJM Tracker while transmission congestion costs related to OSS and any net LSE FTR revenues will be included in the OSS Margins sharing mechanism.

In the PJM Tracker, I&M will use actual energy consumption data to allocate energy-related PJM costs among the retail customer classes. The following PJM charges will be tracked and allocated among the customer classes on an energy basis:

- Net Operating Reserve
- Net Synchronous Condensing
- Net Regulation Service
- Meter Corrections
- Emergency Purchase
- Inadvertent Meter Reserve
- Day-Ahead Scheduling Reserve Market
- Net Spinning
- Net Transmission Line Loss

All other current PJM charges, including net blackstart, net reactive supply, administrative fees and transmission enhancement charges, will be tracked and allocated among the customer classes on a demand basis.

1 The initial tracker factor will be set at \$39.122 million. Thus, if the Commission
2 approves the Settlement Agreement, I&M will file compliance tariffs reflecting this
3 initial tracker factor. I&M will subsequently file a petition and supporting
4 testimony and exhibits for approval to implement the annual adjustment to the
5 PJM Tracker. In the annual PJM adjustment, the initial tracker factor will be
6 adjusted to reflect costs above and below the amount included in the revenue
7 requirement, a forecast of other PJM costs during the period in which the factor
8 will be in effect, and a reconciliation of historic costs and recoveries.

9 In each annual PJM Tracker proceeding, I&M will identify any new PJM charge or
10 material modification of an existing PJM charge (modified PJM charge) that I&M
11 seeks approval from the Commission to include in the PJM Tracker and any
12 anticipated new or modified PJM charge of which I&M is aware. I&M will present
13 testimony explaining the nature of any new or modified PJM charge and a
14 proposed cost allocation. I&M will also identify any PJM charge discontinued by
15 PJM.

16 I&M's annual PJM Tracker filing will also include a summary of I&M-owned and
17 non-I&M-owned PJM RTEP project costs. The Settlement Agreement provides
18 I&M will maintain its records such that I&M-owned PJM RTEP project costs
19 recognized in the PJM Tracker may be separately identified. I&M will retain such
20 records until a final order is entered in I&M's next general rate proceeding.

21 I&M does not currently have any such I&M-owned RTEP projects. The
22 provisions in the Settlement Agreement will permit proper tracking of any such
23 projects should I&M have I&M-owned RTEP projects in the future.

1 **Q. Please discuss the Environmental Compliance Tracker.**

2 A. In its case-in-chief I&M proposed to track net emission allowance costs and
3 consumables via an Environmental Compliance Tracker. Under the Settlement
4 Agreement, the Environmental Compliance Tracker shall be approved for
5 purposes of tracking only net emission allowances. The Commission has
6 authorized other Indiana utilities to track emission allowances. Thus, the
7 Settlement Agreement is consistent with other Commission decisions.

8 The Settlement Agreement provides that the initial factor under the tracker will be
9 set to recover \$8.5 million. This amount approximately reflects the test year
10 expense shown on I&M Exhibit F-4 (O&M Expense Adjustment No. 7). If the
11 Commission approves the Settlement Agreement, I&M will file compliance tariffs
12 reflecting this initial tracker recovery. I&M will subsequently file a petition and
13 supporting testimony and exhibits for approval to implement the annual
14 adjustment to the Environmental Compliance Tracker. In the annual proceeding,
15 the initial factor will be reconciled and a new factor will be proposed based upon
16 a forecast of net emission allowance costs during the period that the factor will be
17 in effect.

18 While the Settlement Agreement does not include the costs of consumables in
19 the Environmental Compliance Tracker, the Parties agree that I&M may request
20 timely cost recovery via a rate adjustment mechanism of consumables and other
21 ratemaking relief pursuant to the Indiana statutes and Commission rule
22 concerning qualified pollution control property, clean coal technology and clean
23 coal and energy projects.

As noted in the rebuttal testimony of I&M witness McCullough (at 8-9), I&M currently plans to file a petition concerning its activated carbon injection (ACI) systems at Rockport and the selective non-catalytic reduction (SNCR) systems at Tanners Creek. This is consistent with the testimony of OUCC witness Pruett (at 12-17). While the OUCC and Intervenors may not contest I&M's right to file such requests, the Settlement Agreement does not otherwise restrict the positions the OUCC and Intervenors may take with regard to the relief sought by I&M in any such proceeding.

Q. The Settlement Agreement provides for annual adjustment of the OSS Margins sharing mechanism, PJM Tracker, and Environmental Compliance Tracker. When will these annual proceedings be initiated?

A. The Settlement Agreement reflects the Parties' consensus that annual tracker proceedings will be more efficient than quarterly or semi-annual proceedings. As reflected in the testimony of OUCC witness Satchwell (p. 23) and my rebuttal testimony, the OUCC and I&M have considered the use of a calendar year projection period and 12-month reconciliation period ending June 30 with each of the tracker filings to be filed on or about August 30 each year. Recognizing that the actual accounting information for the 12 months ended June 30 would not become available until mid-July, this schedule would provide I&M with approximately six weeks to prepare its filing. This schedule was intended to provide appropriate time for review of I&M's filings and implementation of the new tracker factors on or about January 1 of the following year. In order that I&M is not preparing three tracker filings simultaneously, and the Commission and the OUCC are not reviewing those filings concurrently; I would suggest that I&M file

1 the OSS and PJM Trackers at the same time, and that the Environmental
2 Compliance Tracker be filed concurrent with one of I&M's FAC filings.

3 The actual timing of the initial tracker reconciliation proceedings may be
4 dependent on the order in this case and the effective date of the new tariffs.
5 Thus, the schedule contemplated above may need to be adjusted to better reflect
6 the date of the Commission's decision in this case and the implementation of the
7 initial tracker factors. I&M commits to working with the Commission and the
8 Parties in this regard. In addition, I&M will work with the Parties to develop
9 templates for schedules and workpapers for these proceedings.

10 **Q. Please discuss the Demand Side Management/Energy Efficiency (DSM/EE)**
11 **Tracker.**

12 A. The Settlement Agreement provides that the DSM/EE Tracker should be
13 approved for purposes of tracking certain costs related to DSM/EE programs.
14 The initial factor under the DSM/EE Tracker will be set at zero to reflect the
15 OUCC's recommendation that \$2.537 million be included in the revenue
16 requirement used to establish basic rates to recognize the cost of the initial
17 programs. The Settlement Agreement identifies the following initial programs:
18 energy education; tariff education; low income weatherization; residential and
19 small commercial compact fluorescent lighting; home energy fitness; commercial
20 and industrial lighting; commercial and industrial motors; and commercial and
21 industrial standard offer.

22 The Settlement Agreement also provides that during the 45 days following
23 execution of the Agreement, I&M will meet with any interested Party to discuss

1 the initial programs and receive input regarding design and roll-out. This
2 provision recognizes that the Company welcomes input from the Parties on the
3 initial programs but also reflects the importance of I&M being in a position to
4 proceed with the programs in a timely manner following a Commission decision
5 regarding the Settlement Agreement.

6 In the event that I&M's annual costs for the initial DSM/EE programs are less
7 than the \$2.537 million reflected in the revenue requirement, the difference will
8 be reconciled at the time a new factor is authorized in accordance with the
9 DSM/EE collaborative. Because this provision concerns an annual expense
10 embedded in basic rates, a full 12-month period following the implementation of
11 new rates may need to elapse before the difference, if any, can be identified.
12 I&M commits to working with the Parties and the Commission to implement this
13 provision, particularly if a new factor resulting from the DSM/EE collaborative is
14 sought before the 12-month period elapses.

15 The Settlement Agreement acknowledges that the OUCC and I&M have been
16 engaged in a collaborative effort regarding DSM/EE. The Settlement Agreement
17 provides that the collaboration will continue with the OUCC and any other Party.
18 Also, the Commission (or its designated representative) is invited to participate in
19 the collaborative. The DSM/EE collaborative will consider new or revised
20 programs developed in accordance with the Market Potential Study currently
21 being performed and I&M will be authorized to track via the DSM/EE Tracker the
22 costs of such new or revised programs in the aggregate greater than the \$2.537
23 million embedded in basic rates, subject to Commission approval.

1 The Parties submitted testimony contesting I&M's proposal regarding lost
2 revenues and shared savings incentive. As noted above, the initial tracker factor
3 is set at zero. In other words, the initial tracker will not include recovery for lost
4 revenues or shared savings incentives. The Settlement Agreement provides that
5 lost revenues and any incentives, as well as the design of the tracker and the
6 nature of programs, will be addressed in the collaborative and presented to the
7 Commission for review and approval.

8 The testimony submitted by the Parties contested the allocation of DSM/EE
9 costs. Under the Settlement Agreement, program costs included in the revenue
10 requirement used to establish basic rates will be allocated among all customer
11 classes, including industrial customers. With the exception of a direct load
12 control program, additional DSM/EE costs included in the DSM/EE Tracker or
13 otherwise recognized for ratemaking purposes will not be allocated to industrial
14 customers. In the event a direct load control program is proposed, the cost
15 allocation for such program may be presented to the Commission for decision. If
16 after four years from the date of a Final Order in this Cause, a DSM/EE program
17 is proposed for industrial classes, allocation of the costs for such program to the
18 industrial classes may also be proposed in a proceeding where approval of such
19 program is sought.

20 **Q. How does the Settlement Agreement address I&M's Reliability**
21 **Enhancement Tracker proposal?**

22 **A.** I&M considered the Reliability Enhancement Tracker to be an innovative and
23 appropriate way to address certain challenges, such as aging infrastructure and

1 workforce and the need to better align reliability with modern technology. The
2 other Parties had significant concerns about departing from the traditional
3 regulatory paradigm for reflecting the costs of the projects in the revenue
4 requirement. In her rebuttal testimony, witness Murray provided additional
5 testimony explaining why I&M continued to believe the Reliability Enhancement
6 Tracker is an important and appropriate ratemaking tool.

7 As part of the give and take of the negotiation process, I&M agreed that the
8 Settlement Agreement will not establish a Reliability Enhancement Tracker for
9 purposes of tracking certain incremental expenses related to reliability
10 enhancement projects. Instead, to provide support for projects, such as those
11 set forth on OUCC witness Catlin Exhibit TSC-20, additional operation and
12 maintenance costs totaling \$7.542 million are reflected in the revenue
13 requirement used to establish basic rates. The projects in witness Catlin's
14 schedule include costs associated with the workforce planning for the Cook
15 Plant, enhanced vegetation management for distribution and transmission
16 facilities and other measures. The projects shown in witness Catlin Exhibit TSC-
17 20 are a small subset of the projects proposed in my Exhibit KDC-4.

18 From I&M's perspective, the compromise reflected in the Settlement Agreement
19 is an important part of the overall package because it will support I&M's ongoing
20 ability to provide the reliable service our customers appreciate. Additionally, the
21 language reflected in this Settlement Agreement recognizes that I&M should
22 have some flexibility to modify the referenced operation and maintenance
23 projects going forward and balances this need with the other Parties' interest in

1 understanding I&M's plans and activities. Thus, for four years, I&M will provide
2 an annual report to the OUCC and the Commission regarding the enhanced
3 operation and maintenance activities, including the actual project results and any
4 changes in project plans from those identified on witness Catlin Exhibit TSC-20
5 (unless previously reported). The Parties expect this annual report to be
6 provided by March 31, each year, beginning in 2010.

7 **Q. Please discuss the resolution of the issue regarding Member Load Ratio.**

8 A. The revenue requirement used to establish basic rates in this proceeding reflects
9 the use of Member Load Ratio (MLR) set at 0.19273. In addition, this agreed-
10 upon MLR is used to establish the initial factors for the OSS Margins sharing
11 mechanism and PJM Tracker. The initial tracker factors will be reconciled using
12 the actual monthly MLR established under the AEP Interconnection Agreement
13 and subsequent tracker factors will be established using a projected MLR for the
14 forecast period and the actual MLR for the reconciled months. The use of the
15 OUCC's proposed MLR in this case will not be used as a precedent by any party
16 to support the use of a five-year averaging methodology in any future
17 proceeding.

18 **Q. Please reconcile the use of the agreed upon MLR with I&M's case-in-chief**
19 **filing.**

20 A. For the MLR-affected items included in basic rates, the adopted MLR has the
21 effect of increasing I&M's adjusted pre-tax operating income (and thus reducing
22 required rate relief) by approximately \$9 million and increasing its (after-tax)
23 NEOI by approximately \$5.5 million (Exhibit KDC-S2).

1 **Q. Please discuss the Settlement Agreement provisions regarding Nuclear**
2 **Regulatory Commission Fees.**

3 A. OUCC witness Catlin proposed that I&M's proposed expense for Nuclear
4 Regulatory Commission fees be reduced to reflect more recent information
5 regarding this expense. This adjustment was accepted in my rebuttal testimony
6 and is incorporated into the Settlement Agreement. Thus, the Settlement
7 Agreement reflects that I&M's expense for Nuclear Regulatory Commission fees
8 is reduced by \$376,000 for purposes of the revenue requirement used to
9 establish basic rates in this proceeding. The relevant exhibit in I&M's case-in-
10 chief filing is Exhibit F-4 (O&M Expense Adjustment No. 22).

11 **Q. How does the Settlement Agreement resolve the dispute regarding major**
12 **storm damage expense?**

13 A. In its case-in-chief I&M provided evidence concerning its test year level of major
14 storm expense and the need to make an appropriate adjustment to the test year
15 level to more accurately represent the normalized level of expense in this area.
16 I&M proposed to use a three-year average for its adjustment consistent with the
17 methodology used in I&M's last rate case. OUCC witness Catlin agreed that
18 major storm expense should be normalized but noted that the three-year average
19 used by I&M included the significant costs associated with a major ice storm in
20 the Muncie area in 2005. Witness Catlin proposed to exclude this major storm
21 from the normalization calculation. To normalize major storm expense, OUCC
22 witness Catlin used a five-year average that excluded 2005. On rebuttal, I&M
23 witness Boyd testified that given the importance of timely restoration of service
24 following a storm event, I&M should be permitted to fully recognize its storm

1 restoration costs. Witness Boyd disagreed with Mr. Catlin's recommended
2 approach, explaining that the methodology Mr. Catlin proposed would exclude
3 the 'high cost' year for ratemaking purposes, which is not representative of I&M's
4 true restoration costs for major storms. Boyd Rebuttal at 14. Major storms are
5 random and unpredictable events that can vary in size and significance as well
6 as the impact they have on I&M's Distribution and Transmission systems. See
7 Boyd Rebuttal at 12-13. I&M explained that its proposal to use the three year
8 normalization period for major storm expense is consistent with the approach
9 used in I&M's last rate case, Cause No. 39314, and explained that the use of a
10 consistent normalization methodology is reasonable.

11 Thus, while I&M and the OUCC agreed that major storm expense should be
12 normalized we disagreed regarding the methodology to be used for this purpose.
13 The Settlement Agreement accepts the OUCC's proposal of a five-year average,
14 but recognizes I&M's position that 2005 should be included in the five-year
15 period. Therefore, the Settlement Agreement provides that major storm damage
16 expense included in the revenue requirement for basic rates is based on a five-
17 year average. Accordingly, the revenue requirement used to establish basic
18 rates in this proceeding includes an adjustment to I&M's test year operating
19 results for distribution service storm damage in the amount of \$4.75 million and
20 an adjustment to I&M's test year operating results for transmission services
21 storm damage in the amount of \$20,000. The relevant exhibit in I&M's case-in-
22 chief is Exhibit F-4 (O&M Expense Adjustment Nos. 11 and 12).

1 **Q. Please discuss the Settlement Agreement provisions regarding Pension**
2 **and Other Post Employment Benefit (OPEB) Expense.**

3 A. The OUCC's testimony reflected a May 2008 actuarial report estimate of pension
4 and OPEB expense. This information was not available at the time the Company
5 prefiled its case in chief. As explained in witness Catlin's testimony, the 2008
6 actuarial report reflects increased pension cost and slightly reduced OPEB cost.
7 This adjustment was accepted in my rebuttal testimony and is incorporated into
8 the Settlement Agreement. Accordingly, the Settlement Agreement provides that
9 the revenue requirement used to establish basic rates includes an additional
10 \$906,000 of pension and OPEB expense, as reflected in the OUCC testimony
11 and I&M rebuttal testimony. The relevant exhibit in I&M's case-in-chief filing is
12 Exhibit F-4 (O&M Expense Adjustment No. 20).

13 **Q. How does the Settlement Agreement address the prepayment I&M made to**
14 **the employees' pension fund?**

15 A. I&M's case-in-chief includes in rate base the prepayment balance of the
16 contribution to the employees' pension fund pre-paid by I&M. The Industrials and
17 the OUCC opposed this treatment. On rebuttal, I&M presented testimony in
18 response to the issues raised by these other Parties. Among other things,
19 witness McCoy (at 5) testified that the pension contribution was not "required" but
20 was made to maintain a well-managed pension plan. Witness McCoy (at 7) also
21 explained the difference associated with accrued pension cost based on accrual
22 accounting in accordance with FAS 87, the method used in I&M's last rate order,
23 and the funding requirements under ERISA (a method sometimes used for
24 ratemaking purposes by other utilities). Witness McCoy also presented his view

1 that the inclusion of the prepaid pension asset in rate base is necessary to
2 provide the Company the opportunity to recover the cost of capital for the
3 investor funds advanced to make the prepayment. He explained that the
4 prepayment lowers both the current and future pension cost. McCoy Rebuttal at
5 10. In his view customers should not receive the benefit of the prepayment
6 without compensating I&M for the cost incurred to provide the benefit.

7 The Settlement Agreement reflects a negotiated compromise on this issue.
8 Under the Settlement Agreement, the contribution to the employees' pension
9 fund pre-paid by I&M is not included in I&M's rate base in this case. Instead, the
10 contribution to the employees' pension fund pre-paid by I&M will earn the lower
11 test year long term debt carrying cost rate of 5.98%. This increases I&M's
12 revenue requirement for basic rates by \$2.894 million for the long term debt
13 carrying cost. The relevant exhibit in I&M's case-in-chief filing is Exhibit F-5
14 (including Rate Base Adjustment No. 10).

15 **Q. Please explain the Settlement Agreement provisions regarding the**
16 **amortization of New Source Review (NSR) Settlement costs, deferred OPEB**
17 **costs and rate case expense.**

18 **A.** The OUCC contested the inclusion of certain costs associated with the New
19 Source Review (NSR) Consent Decree. In I&M's view it is appropriate to
20 recognize the costs of the negotiated compromise reflected in the NSR
21 settlement agreement. It is my understanding that other Indiana utilities with
22 similar consent decrees have had such costs recognized for ratemaking
23 purposes.

1 As part of the overall settlement package, the Parties agreed that the revenue
2 requirement used to establish basic rates includes the Indiana jurisdictional
3 portion of NSR-related expenses for legal fees and mobile source reduction
4 projects, which amount to \$4,302,112 (total Company), to be amortized over
5 three years. Based on the jurisdictional allocation factor of 0.654519, the Indiana
6 retail jurisdictional costs are \$2,815,814 and the amortization results in an
7 additional \$938,604 in the annual revenue requirement. This amount is
8 substantially less than the \$3,834,000 (total Company) reflected in I&M's case-in-
9 chief. The relevant exhibit in I&M's case-in-chief filing is Exhibit F-4 (O&M
10 Expense Adjustment No. 6).

11 The Settlement Agreement also provides that the revenue requirement used to
12 establish basic rates includes I&M's OPEB costs deferred pursuant to the
13 Commission's order in Cause No. 39314 and rate case expense amortized over
14 a three-year period. The relevant exhibit in I&M's case-in-chief filing is Exhibit F-
15 4 (O&M Expense Adjustment Nos. 21 and 22, respectively).

16 I&M will submit to the Commission Staff, as a compliance filing, tariff sheets
17 reflecting the removal of the NSR expense, as well as the three-year
18 amortizations of OPEB expense and rate case expense, from I&M's basic rates
19 after the expenses have been fully amortized unless new rates have already
20 been approved reflecting the removal or subsequent adjustment of the
21 amortizations.

22 **Q. Please discuss the provisions of the Settlement Agreement concerning**
23 **Nuclear Fuel Inventory.**

1 A. As explained in the rebuttal testimony of witness Hawkins (at 6), I&M currently
2 owns \$50.153 million of nuclear fuel inventory used at the Cook Nuclear Plant
3 (non-leased nuclear fuel), which amount was removed by adjustment from I&M's
4 rate base for purposes of filing I&M's case-in chief in anticipation that I&M would
5 be able to lease all of its nuclear fuel. Due to exigent market conditions this
6 inventory balance has not been placed under lease. Therefore, this rate base
7 adjustment is no longer fixed, known and measurable. Accordingly, the
8 Settlement Agreement includes the non-leased nuclear fuel in I&M's rate base in
9 this case. The relevant exhibit in I&M's case-in-chief filing is Exhibit F-5 (Rate
10 Base Adjustment No. 9).

11 I&M will continue to pursue opportunities to lease the remaining portion of its
12 nuclear fuel inventory. I&M will report annually to the OUCC on I&M's efforts and
13 to the Commission upon request. In the event I&M succeeds in leasing the
14 remaining portion, I&M will submit tariff sheets reflecting the removal of the
15 nuclear fuel inventory from rate base to the Commission Staff as a compliance
16 filing.

17 **Q. Does the Settlement Agreement provide for approval of I&M's tariffs?**

18 A. Yes. The Settlement Agreement provides for approval of I&M's tariffs, including
19 rules and regulations, consistent with the resolution of the identified disputes set
20 forth in the Settlement Agreement.

21 **Q. Please discuss the provisions of the Settlement Agreement relating to**
22 **Demand Response.**

1 A. I&M will revise its tariffs to reflect the Commission's finding in Cause No. 43566
2 upon issuance of a final order in such investigation. Pending a decision in Cause
3 No. 43566, customers seeking to participate in demand response programs will
4 do so only through programs reviewed and approved by the Commission.

5 **Q. Please discuss the provisions of the Settlement Agreement relating to**
6 **Reporting for the Economic Development Rider and Experimental Real-**
7 **Time Pricing Tariff.**

8 A. I&M will report annually to the Commission and the Parties: (a) the number of
9 customers that have chosen the Economic Development rate and their aggregate
10 cumulative load; and (b) the estimated customer savings realized under the
11 Experimental Real-Time Pricing Tariff and the estimated impact on I&M's peak
12 demands, provided that the confidential information associated with both reports
13 is exempted by the Commission from public disclosure and received by each
14 Party pursuant to a reasonable non-disclosure agreement.

15 **Q. Please discuss the provisions of the Settlement Agreement relating to**
16 **Terms and Conditions of Service, Extension of Service, Section 14(d).**

17 A. I&M proposed to add paragraph (d) to Section 14 of its terms and conditions of
18 service. Section 14 applies to extension of service. The Settlement Agreement
19 expanded the revisions to Section 14 in response to concerns about this new
20 tariff language raised in the OUCC's testimony. The Settlement Agreement
21 provides that Section 14(d) of I&M's terms and conditions of service will be
22 approved as follows:

1 If the Company has reason to question the financial stability of the
2 customer and/or the life of the operation is uncertain or temporary
3 in nature, such as construction projects, oil and gas well drilling,
4 sawmills and mining operations, the customer shall pay a
5 contribution in aid of construction, consisting of the estimated labor
6 cost to install and remove the facilities required plus the cost of
7 unsalvageable material, before the facilities are installed. In
8 making determinations under this provision, I&M will consider
9 relevant information such as financial statements, annual reports,
10 and other information provided by the customer. Should a dispute
11 arise concerning the application of this provision, either the
12 Company or the customer may submit such dispute to the
13 Commission for investigation and determination as to the conditions
14 under which such extension shall be made.

15 To provide for regulatory oversight the Settlement Agreement also provides that,
16 if I&M communicates to a customer that a contribution in aid of construction
17 under Section 14(d) is necessary, I&M will copy the Commission and the OUCC,
18 or their respective designee, on the communication to the customer.

19 **Q. Please discuss the provisions of the Settlement Agreement relating to**
20 **Miscellaneous Service Charges.**

21 A. The OUCC proposed that increases to I&M's miscellaneous service charges
22 should be limited to no more than a 25% increase over the current charges as
23 shown in witness Swan Schedule DES-9. In its rebuttal testimony, I&M proposed
24 that the reduced charges proposed by the OUCC be implemented for the first
25 year that the new rates are in effect. Thereafter, I&M proposed that in each of
26 the subsequent three (3) years, the customer charges will be increased by 1/3 of
27 the difference between the full cost-based charges and the first year charge,
28 such that at the beginning of the fourth year after new rates have been put into
29 effect (approximately 2012), the charges will reflect full 2007 costs. The Parties
30 accepted this phase-in plan in the Settlement Agreement. As a result, the

1 schedule of miscellaneous service charges shall be as set forth in witness Roush
2 Exhibit DMR-R4.

3 **Q. Please discuss the provisions of the Settlement Agreement relating to**
4 **Tariffs C.S.-IRP2, ECS and EPCS.**

5 A. As explained in the Settlement Agreement, the Industrials challenged the 200
6 MVA limitation on the availability of Tariff C.S.-IRP2. Through the rebuttal
7 testimony of I&M witness Roush, I&M explained that limitations on the amount of
8 interruptible service available have been a part of I&M's tariffs for decades so as
9 to balance the provision of a rate discount to an interruptible customer today with
10 the future benefit of deferring the need for constructing additional generating
11 capacity. I&M explained that the increase in the availability of interruptible
12 service from 135 MVA to 200 MVA of customer load under contract represents a
13 48% increase in the amount of interruptible service offered to I&M's customers.
14 As reflected by the Settlement Agreement, the Parties agreed to approval of the
15 increase in the availability of interruptible service from 135 MVA to 235 MVA of
16 customer interruptible load under contract. This is a 100 MVA increase over the
17 current level.

18 Industrial witness Dauphinais also challenged certain aspects of the pricing and
19 terms for Tariff C.S.-IRP2 and Rider ECS. I&M also explained that, in its view, it
20 is not appropriate to institute an asymmetrical relationship where customers pay
21 for electric service based upon average embedded costs but are paid for demand
22 response based upon market value. In the Settlement Agreement, the Parties
23 agreed that the minimum interruption requirement for mandatory curtailments

1 under Tariff C.S.-IRP2 shall be the minimum required under the PJM Emergency
2 program for capacity. The Parties also agreed that the minimum compensation
3 under Tariff C.S.-IRP2 shall be 80% of the applicable PJM Reliability Pricing
4 Model (RPM) clearing price and the curtailment credit under Rider ECS shall be
5 more like the credit provided under Rider EPCS. Thus, the curtailment credit
6 under Rider ECS shall be the greater of the following: (a) 80 percent of the AEP
7 East Load Zone Real-Time Locational Marginal Price (LMP) established by PJM
8 (including congestion and marginal losses); (b) the amount quoted by I&M to the
9 customer; or (c) the Minimum Price as specified by the customer provided that
10 minimum price does not exceed \$500 per MWh.

11 I&M has been submitting a monthly confidential Tariff CS-IRP interruption report
12 to the Commission and OUCC. In the Settlement Agreement, the Parties provide
13 that this confidential report will be continued on a quarterly basis and expanded
14 to include Tariff C.S.-IRP2 and Riders ECS and EPCS.

15 Finally, the Industrials also proposed to eliminate the testing requirement within
16 Riders ECS and EPCS and Tariff C.S.-IRP2. On rebuttal, I&M witness Roush
17 explained that the testing provision ensures that there are no problems with
18 either the agreed upon notification process or the customer's plan of action to
19 interrupt when a request is received. The Parties agree that I&M may reserve
20 the right to verify the customer's ability to interrupt or curtail service under Tariff
21 C.S.-IRP2 and Riders ECS and EPCS provided that the verification process will
22 stop one step short of actual physical interruption or curtailment.

1 **Q. Does the Settlement Agreement fix a base cost of fuel for I&M's Fuel**
2 **Adjustment Charge (FAC) Proceedings?**

3 A. Yes. The Parties agreed that for purposes of I&M's FAC proceedings, I&M's
4 base cost of fuel shall be \$0.011786 per kWh. The Parties further agreed that
5 the procedures required by the Commission's generic order in Cause No. 41363
6 shall continue to be waived, unless atypical conditions arise in accordance with
7 my direct testimony. For purposes of this provision, atypical conditions shall be
8 defined as a monthly average actual cost of retained cash purchases (excluding
9 AEG and OVEC committed purchases) exceeding the AEP System's highest
10 average monthly on-system fuel cost and a volume of retained cash purchases
11 that exceed 2% of I&M's net energy requirements. The Settlement Agreement
12 does not preclude parties in I&M's fuel cost proceedings from questioning the
13 reasonableness of purchased power transactions.

14 **Q. Please explain how the rate increase will be implemented if the**
15 **Commission approves the Settlement Agreement.**

16 A. The Settlement Agreement requests the Commission approve the Settlement
17 Agreement by January 31, 2009. Upon Commission approval and consistent
18 with established Commission practice, I&M will submit its new Tariff to the
19 Commission Staff for approval so that the new rates may be placed into effect as
20 soon as possible following the entry of a Commission order.

21 The Settlement Agreement also provides that I&M shall be authorized to place
22 into effect rates in accordance with the terms of this Agreement for bills rendered
23 on and after the effective date of the order approving this Agreement. As

1 discussed with the other Parties, I&M will implement the new rates in the same
2 way that I&M has implemented past rate increases by prorating initial bills for
3 service following the effective date to reflect the number of days associated with
4 the new rates and the number of days associated with the existing rates.

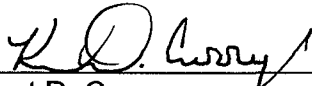
5 **Q. Does this conclude your prepared supplemental testimony?**

6 **A. Yes.**

VERIFICATION

I, Kent D. Curry, Director of Regulatory Services for Indiana Michigan Power Company, affirm under penalties of perjury that the foregoing representations are true and correct to the best of my knowledge, information and belief.

Date: 12/9/08



Kent D. Curry

Indiana Michigan Power Company
Total Settlement Revenues - 25% Subsidy Reduction
Twelve Months Ended September 30, 2007

<u>Class</u> (1)	<u>Current Revenue</u> (2)	<u>Base Rate Increase</u> (3)	<u>Proposed Revenue</u> (4)=(2)+(3)	<u>DSM/EE Program Cost Rider</u> (5)	<u>Environmental Compliance Cost Rider</u> (6)	<u>Off-System Sales Margin Sharing Rider</u> (7)	<u>PJM Cost Rider</u> (8)	<u>Total Proposed Revenue</u> (9)=(4)+(5)+(6)+(7)+(8)	<u>Total Proposed Increase</u> (10)=(9)-(2)	<u>Proposed Increase %</u> (11)=(10)/(2)
RS	\$340,677,463	\$14,768,332	\$355,445,795	\$0	\$2,906,784	(\$8,517,888)	\$13,415,553	\$363,250,244	\$22,572,780	6.63%
SGS	\$24,859,125	\$1,185	\$24,860,310	\$0	\$163,587	(\$479,639)	\$754,726	\$25,298,984	\$439,859	1.77%
MGS/LGS	\$277,901,248	\$4,091,792	\$281,993,040	\$0	\$2,655,247	(\$7,822,302)	\$12,225,510	\$289,051,496	\$11,150,248	4.01%
IP	\$182,538,543	\$1,751,012	\$184,289,555	\$0	\$2,311,525	(\$6,857,908)	\$10,603,115	\$190,346,287	\$7,807,744	4.28%
MS	\$3,522,055	(\$46,916)	\$3,475,139	\$0	\$30,170	(\$89,059)	\$138,741	\$3,554,992	\$32,937	0.94%
WSS	\$6,998,139	\$55,505	\$7,053,644	\$0	\$89,753	(\$266,877)	\$411,255	\$7,287,775	\$289,636	4.14%
IS	\$42,943	(\$1,151)	\$41,792	\$0	\$315	(\$937)	\$1,442	\$42,612	(\$331)	-0.77%
EHG	\$1,071,505	\$43,835	\$1,115,340	\$0	\$8,922	(\$26,011)	\$41,280	\$1,139,531	\$68,027	6.35%
EHS	\$776,319	\$17,495	\$793,814	\$0	\$6,505	(\$19,072)	\$30,010	\$811,257	\$34,938	4.50%
OL	\$5,409,556	\$269,450	\$5,679,006		\$26,135	(\$78,881)	\$118,798	\$5,745,058	\$335,502	6.20%
SL	\$4,381,818	(\$71,935)	\$4,309,883	\$0	\$37,991	(\$114,603)	\$172,754	\$4,406,026	\$24,208	0.55%
Subtotal	\$848,178,713	\$20,878,605	\$869,057,318	\$0	\$8,236,932	(\$24,273,175)	\$37,913,186	\$890,934,261	\$42,755,548	5.04%
Interruptible	\$59,762,995		\$59,060,259	\$0	\$263,522	(\$781,825)	\$1,208,792	\$59,750,747	(\$12,248)	-0.02%
Misc Service Revenues	\$1,819,331		\$3,243,463					\$3,243,463	\$1,424,132	78.28%
Subtotal - Rate Design	\$909,761,039	\$21,600,001	\$931,361,040	\$0	\$8,500,454	(\$25,055,000)	\$39,121,977	\$953,928,472	\$44,167,433	4.85%
Revenue Verification Diff.		(\$1)	(\$1)	\$0	(\$454)	\$0	\$23	(\$432)	(\$432)	
Total - Target Revenues	\$909,761,039	\$21,600,000	\$931,361,039	\$0	\$8,500,000	(\$25,055,000)	\$39,122,000	\$953,928,040	\$44,167,001	4.85%

Indiana Michigan Power Company
Reconciliation of I&M Third Revised Exhibit F-1 and Settlement Agreement Exhibit A

<u>Description</u>	<u>Pre-Tax Adjustment (\$000)</u>	<u>Tax Effect</u>	<u>NEOI (\$000)</u>
Net Electric Operating Income (NEOI) Per I&M Third Revised Exhibit F-1			<u>\$ 113,054</u>
Move OSS Margin Guarantee From Tracker to Basic Rates	\$ 37,500	0.61	22,875
MLR Effect: Increased Capacity Settlement Receipts From AEP Pool	8,180	0.61	4,990
MLR Effect: Decreased Third Party Transmission Revenues From AEP Pool	(322)	0.61	(196)
Move PJM Administrative Costs From Tracker to Basic Rates	(5,227)	0.61	(3,188)
NSR Amortization: Remove Amortization From Rates After 3rd Year	1,571	0.61	958
MLR Effect: Increased Transmission Equalization Agreement (TEA) Receipts	1,121	0.61	684
Decrease Expense By Normalizing Major Storm Expense Over 5 Yrs Including 2005	1,633	0.61	996
Increase Pension/OPEB Expense to Latest Information	(906)	0.61	(553)
Decrease NRC Annual Fees to Latest Information	376	0.61	229
Decrease Economic Development Expense	-	0.61	-
Decrease Nuclear Decommissioning Expense to \$8.1 Million	10,600	0.61	6,466
Move Commercial Operations Expense to OSS Margins Tracker	963	0.61	587
Move DSM Program Costs to Basic Rates	(2,537)	0.61	(1,548)
Move OUCC-Recommended RET O&M Projects + Aging Workforce to Basic Rates	(7,542)	0.61	(4,601)
Synchronized Interest on Rate Base Adjustment	506	0.61	309
Prepaid Pension: Return at a L/T Debt Rate of 5.98%	(2,894)	0.61	(1,765)
Adjustments - OPEB and rate case expense - eliminate after 3 year amortization period			
Net Electric Operating Income (NEOI) Per Settlement Agreement Exhibit A			<u>\$ 139,297</u>

INDIANA MICHIGAN POWER COMPANY
COST OF CAPITAL - INDIANA BASIS
AS OF SEPTEMBER 30, 2007

(1)	(2)	(3)	(4)	(5)
DESCRIPTION	BALANCE	RATIO	COST RATE	WEIGHTED COST RATE
	\$	%	%	%
1 LONG TERM DEBT (2)	1,312,000,000	43.53	5.98	2.60
2 PREFERRED STOCK (3)	8,080,200	0.27	7.05	0.02
3 COMMON EQUITY (4)	1,380,402,854	45.80	10.50	4.81
4 3% ACC. DEF. ITC	0	0.00	0.00	0.00
5 ACC. DEF. JDITC (1)(7)	51,678,951	1.71	8.30	0.14
6 ACC. DEF. FIT (6)	236,336,188	7.85	0.00	0.00
7 CUSTOMER DEPOSITS (5)	25,288,692	0.84	6.00	0.05
8 TOTAL	<u>3,013,786,885</u>	<u>100.00</u>		<u>7.62</u>

(1) ACC. DEF. JDITC COST RATE :

DESCRIPTION	BALANCE	RATIO	COST RATE	WEIGHTED COST RATE
	\$	%	%	%
LONG TERM DEBT	1,312,000,000	48.58	5.98	2.91
PREFERRED STOCK	8,080,200	0.30	7.05	0.02
COMMON EQUITY	<u>1,380,402,854</u>	<u>51.12</u>	10.50	<u>5.37</u>
TOTAL	<u>2,700,483,054</u>	<u>100.00</u>		<u>8.30</u>

(2) INCLUDES LONG TERM DEBT DUE IN ONE YEAR; EXCLUDES UNAMORTIZED DISCOUNT PREMIUM AND EXPENSE, LEASED ASSETS, AND PRE APRIL 7 SPENT FUEL DISPOSAL.

(3) INCLUDES PREMIUM ON PREFERRED STOCK.

(4) COMMON EQUITY:

COMMON STOCK	56,583,866
PREMIUM ON CAPITAL STOCK	4,317,933
PAID-IN CAPITAL	842,410,709
APPROPRIATED RETAINED EARNINGS - AMORT. RESV. (A/C 2151000) E.O.P.	1,200,663
RETAINED EARNINGS UNAPPROPRIATED - RESTR.(A/C 2160001)	453,237,115
UNAPPROPRIATED UNDISTRIBUTED SUBSIDIARY EARNINGS (TOTAL)	4,972,443
UNAPP. RETAINED EARNINGS - RESTRICTED/BOND INDENTURES (A/C 2160002)	5,900,000
LESS: LONG-TERM DEBT INTEREST RATE HEDGE	<u>(11,780,125)</u>
TOTAL COMMON EQUITY	<u>1,380,402,854</u>